

Arts Council of England: Monitoring major capital projects funded by the National Lottery



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Executive summary

Introduction

1 This report examines the way in which the Arts Council manage the risks during the construction phase of major capital projects funded by the National Lottery. In the four years from the launch of the National Lottery to 31 October 1998, the Arts Council, under their capital programme, had made 2,055 awards of lottery funds totalling £1 billion.

2 The National Lottery has more than doubled the funds available for distribution to the arts in England and the arts sector has seen a huge and unprecedented increase in the number and scale of capital projects. One key feature of the Arts Council's lottery distribution is the substantial amount of lottery funds that have been awarded to a small number of projects. They have awarded £513 million, 51 per cent of the value of their capital programme, to only 28 major projects - each of which has received a grant of £5 million or more. The Arts Council normally fund up to 75 per cent of the cost of a project and require the balance to be raised by the grant recipient as partnership funding.

3 The management of these capital projects, and the resolution of any problems, rests with the grant recipient. However, the Arts Council have a substantial investment in each project and are concerned to ensure its successful completion. They also have a duty under the Financial Directions issued by the Department for Culture, Media and Sport to safeguard lottery funds. The Arts Council must therefore monitor each project to ensure it is properly managed, adequately financed, built to an appropriate standard and delivers the benefits intended. They must also ensure that problems and risks identified by their project monitoring are addressed properly by the grant recipient and that any action taken will not compromise unduly the quality of the project.

4 We focused our examination on 15 of the 28 major projects. These are listed in the table below, along with the total amount of lottery grant awarded by the Arts Council as at 31 October 1998. A brief description of each project is set out at the back of the Report.

Project	Lottery grant £	Project	Lottery grant £
Royal Opera House, London	78,500,000	Victoria Hall & Regent Theatre, Stoke-on-Trent	16,135,000
Sadler's Wells Theatre, London	36,000,000	Shakespeare Globe, London	12,400,000
Royal National Theatre, London	31,590,000	National Centre for Popular Music, Sheffield	11,085,000
Royal Academy of Dramatic Art, London	23,746,841	Cambridge Arts Theatre	7,390,000
Royal Exchange Theatre, Manchester	23,057,250	National Glass Centre, Sunderland	6,901,000
Royal Albert Hall, London	20,200,000	Dovecot Arts Centre, Stockton-on-Tees	6,631,750
Milton Keynes Theatre and Gallery	20,171,485	Malvern Festival Theatre	5,087,640
Royal Court Theatre, London	18,825,850		
		Total	317,721,816

5 In each case, significant progress had been made in terms of the building work completed and the amount of lottery funds paid out by the Arts Council to the grant recipient. Whilst these 15 projects represent less than one per cent of the total number approved, they account for 31 per cent, by value, of the grants made under the Arts Council's capital programme. They also represent some of the most risky projects supported by the Arts Council, due to their size and complexity. In addition, each of them received lottery awards before the Arts Council strengthened their application and assessment arrangements. Five of the 15 projects have now been completed. We examined two issues:

- how the Arts Council monitor the progress of major capital projects prior to completion; and
- what action the Arts Council have taken when monitoring has identified risks to project objectives, including budgets and timescales, and to the longer term financial viability of the grant recipient.

How the Arts Council monitor the progress of major capital projects

6 The Arts Council have, from the outset, adopted a pro-active approach to monitoring lottery-funded projects and have also progressively improved and strengthened their procedures. In April 1996, they established a separate unit, the

Lottery Projects Unit, to be responsible for monitoring, and for each project this work is co-ordinated by a designated Projects Officer. Many staff in the Unit have specialist expertise in one or more areas relevant to monitoring arts capital projects and the Unit also makes extensive use of external specialist advisers in monitoring individual projects. Independent consultants engaged by the Arts Council found this approach to monitoring to be appropriate and made recommendations to strengthen the process, which the Arts Council are implementing.

7 One key feature of the Arts Council's monitoring of large capital projects is the advice obtained from independent Building Monitors. These monitors are the 'eyes and ears' of the Arts Council, reporting progress to the Arts Council's Projects Officers, who are responsible for co-ordinating, monitoring and responding to any problems that emerge. Projects Officers may also call on other internal and external advice. For 12 of the 15 projects we examined, we considered that the Building Monitors provided a good level of service to the Arts Council, providing sufficient information on the progress of projects and alerting them to problems and associated risks. This has provided a sound basis for effective monitoring by the Arts Council.

8 However, for three of the 15 projects, the amount, quality or timeliness of information provided was not fully satisfactory for effective monitoring:

- the Building Monitor provided insufficient and incomplete information and was eventually replaced (the National Centre for Popular Music);
- the Building Monitor did not produce regular written reports (Malvern Festival Theatre); and
- the Building Monitor was unable to obtain essential information from the grant recipient (Victoria Hall and Regent Theatre). The Arts Council were aware of this difficulty and accept that they could have intervened earlier than they did with a written warning to the grant recipient about the non-delivery of information.

Without reliable and timely information, the Arts Council are exposed to risk and poorly placed to respond when problems arise. Two of these three projects have now been completed successfully and the third (Victoria Hall and Regent Theatre) is the subject of close scrutiny by the Arts Council.

9 The Arts Council sought specialist advice from their Business Assessment and Planning team on the financial viability of three of the 15 projects we examined. This team was set up originally to provide specialist financial advice in connection with the Arts Council's grant-in-aid clients. In two of the three cases, the reports produced by this team were seriously deficient and failed to highlight, or understated, the significant financial problems facing the grant recipient. In one case (Cambridge Arts Theatre), the financial difficulties were so severe that they threatened the future of the project and the grant recipient had to turn to the Arts Council for financial support just two months later. The Arts Council subsequently made more use of external consultants and are considering the future of their Business Assessment and Planning function.

10 The Arts Council's Projects Officers play a pivotal role in the monitoring of projects and should have a complete overview of the project at all times. In one case (the Royal Opera House), monitoring involved various different parties, internal and external, some of whom reported direct to senior management. The Arts Council believe that these arrangements were necessary and strengthened their overall monitoring of the project. But they may also have made the co-ordinating role of the Projects Officer more difficult. Also, the ability of the Lottery Projects Unit to monitor progress on this project may have been weakened because of difficulties the Royal Opera House had in providing sufficient and timely information about their financial viability and progress in meeting partnership funding targets.

11 A key risk with any construction of a large and complex capital project is that it may run into problems which result in cost overruns and delays. The Arts Council's monitoring of the 15 projects we examined revealed that almost all have experienced such problems. Twelve of the 15 projects are over budget, six by more than ten per cent, and only eight have been, or are now scheduled to be, completed on time. Five projects were running more than three months late. However, in most cases, the Arts Council will not be exposed to any financial risk.

Recommendations

12 To improve the way they monitor the progress of major capital projects, the Arts Council should:

- take more vigorous and timely action if Building Monitors do not meet the standards required (for example, in providing formal written reports);
- act more promptly to support Building Monitors when they experience difficulty in obtaining information from grant recipients; and

- ensure they have access to adequate financial expertise, either by strengthening the Business Assessment and Planning team or by making greater use of external consultants.

The Arts Council accept these recommendations and have already implemented those concerning Building Monitors, in some cases prior to the completion of our work. They are acting to strengthen their Business Assessment and Planning team to complement the financial and other expertise which they draw on from external consultants.

Action taken by the Arts Council on the outcome of their project monitoring

13 Arts organisations, by their nature, often have limited financial resources and little experience in managing large capital projects. Delays in completing a project, leading to late opening, and higher than expected construction costs, resulting in the need to raise additional financing, can affect an organisation's income stream. The Arts Council are concerned to ensure that the projects they have supported with lottery funds are successful. In responding to problems identified by their project monitoring, the Arts Council have to strike a balance between allowing the project to continue (while keeping the risks to an acceptable level) and halting work (with the costs that would entail) until the problems have been satisfactorily resolved. They work closely with the grant recipient and seek to ensure that the action they take is timely and decisive and addresses the risks identified by their monitoring. Failure to do this would leave their lottery investment exposed to continued, and possibly increasing, risk.

14 Funding difficulties experienced on projects have been most acute where project costs have increased significantly or where the receipt of partnership funding has been slower than originally envisaged. The Arts Council have developed a range of options for dealing with projects that run into financial difficulties during construction:

- they look first to the grant recipient to reduce the scope of the project and to raise additional partnership funding. Twelve of the 15 projects we examined had, at some point, been over budget and this approach had succeeded in dealing with the problem in two cases (Malvern Festival Theatre and Milton Keynes Theatre and Gallery);

- for six of the 15 projects, the Arts Council had appointed a ‘trouble shooter’ or special adviser who provided valuable assistance to the grant recipient and assurance to the Arts Council; and
- in other cases, the Arts Council have temporarily relaxed the timing of their partnership funding requirements and the associated grant payment arrangements and paid more of the project costs up front to help grant recipients overcome cash flow difficulties. In two of these cases (the Royal Academy of Dramatic Art and Sadler’s Wells Theatre), it will be several years before the approved ratio of lottery grant to partnership funding is achieved and until that time the risk will remain that the grant recipients will not be able to make good the shortfall in partnership funding.

15 In some cases, grant recipients have not been able to meet increased project costs in this way and have sought additional lottery money from the Arts Council. Eight of the 15 projects we examined had received a supplementary grant, ranging from 0.6 per cent to 20 per cent of the amount originally awarded. Four projects (Cambridge Arts Theatre, the National Glass Centre, the Royal Court Theatre and Sadler’s Wells Theatre) received supplementary grants of over ten per cent of their original grant. The Arts Council were satisfied, in each case, that the work remaining to be carried out was essential to the success of the project and would add value.

16 For 13 of the 15 projects we examined, the Arts Council attached special conditions to the lottery grants in relation to financial or project management risks. In most cases, the grant recipient satisfied the special conditions attached to the offer of grant. However, in two cases (the Royal Court Theatre and the Royal Opera House), the Arts Council allowed the project to proceed even though the special conditions had not been fully fulfilled and some of the risks that the special conditions were designed to cover still existed. We consider that the Arts Council would have been justified in seeking to take a tougher line than they did in enforcing the special conditions as a means of putting the projects on a sounder footing. However, we recognise that the Arts Council considered the risks in question and weighed these against all the other relevant factors before reaching a decision. In these two cases, the Arts Council judged that adhering to the terms in which the special conditions were originally expressed was not feasible and might have jeopardised further progress on the projects.

17 Where a project is experiencing serious financial difficulties, or where allowing a project to proceed would involve significantly increased risk to lottery funds, it is important that the Arts Council identify all the options available to them,

including halting progress on the project by suspending lottery payments. It is also important to ensure that those options are considered formally and a decision made by the Council or senior officials. In addition, the Lottery Advisory Panel should be kept fully informed at all stages and consulted for advice wherever practicable. Three of the 15 projects we examined (the Royal Academy of Dramatic Art, the Royal Court Theatre and Sadler's Wells Theatre) were experiencing serious financial difficulties. In each case, the Arts Council allowed work to continue, while seeking to ensure that the risks were contained and that the funding difficulties were resolved satisfactorily. Although the Arts Council informed the Lottery Advisory Panel, through written and oral briefings, of the financial risks involved and the different options available, they could, on occasions, have set out the options more formally than they did, together with an explicit invitation to the Panel to consider them. They now ensure that this is done.

18 The Arts Council endeavour to safeguard the use of lottery funds and seek to ensure that the capital projects, when completed, deliver the benefits intended. It is therefore important that the grant recipient is in good general financial health and capable of running the lottery-funded facility once it is completed. However, one of the 15 projects we examined (Cambridge Arts Theatre) experienced unforeseen financial difficulties soon after re-opening and the Arts Council had to work closely with the grant recipient to secure the Theatre's future. In two other cases (the Royal Academy of Dramatic Art and the Royal Opera House), one objective of the projects, following their completion, is to help improve the grant recipients' longer term financial stability. However, in each case, the grant recipient's financial position has deteriorated since the Arts Council made their lottery award. Again, the Arts Council are working with the grant recipients to try to resolve matters.

19 Some of the problems encountered on the 15 projects we examined might have been avoided or reduced if more work on feasibility and project planning had been carried out by applicants at the outset, before an application for lottery funding was made. In July 1997, after these projects were awarded lottery grants, the Arts Council introduced a new three-stage approach to lottery applications (feasibility, development, construction) and funding is now normally only considered and awarded for one stage at a time. This approach was designed to ensure that there is proper planning at the outset. It also allows the Arts Council to carry out a more rigorous assessment of the scale and complexity of the work involved and of the challenge facing the grant recipient in managing the project and raising the partnership funding.

Recommendations

20 Building on the improvements that the Arts Council have made to their procedures since the advent of the National Lottery, we recommend that they should:

- relax the timing of partnership funding requirements and the associated grant payment arrangements only if they are satisfied that the grant recipient will still be able to raise the required total amount of partnership funding within a timescale that will not jeopardise the project or otherwise put lottery funds significantly at risk;
- consider relaxing or deferring special conditions only where they are satisfied that this will not add to the risks which those conditions were designed to cover;
- ensure that, where it appears that proceeding with a project will significantly increase the risk to lottery funds, all the available options are identified, including suspending lottery payments to the project until the problems are resolved and satisfactory proposals have been developed for financing the project through to completion; and
- ensure that the options identified are formally considered by the Council or senior officials and that the Lottery Advisory Panel is kept fully informed at all stages and consulted for advice wherever practicable.

The Arts Council accept, and are already acting on, each of these recommendations.

Part 1: Introduction

1.1 The Arts Council of England (the Arts Council) are the national funding body for the arts in England. They were established on 1 April 1994 as one of the successor bodies to the Arts Council of Great Britain.¹ The operations and activities of the Arts Council are governed by a Royal Charter in which their objectives are stated as:

- to develop and improve the knowledge, understanding and practice of the arts;
- to increase the accessibility of the arts to the public; and
- to advise and co-operate with departments of government, local authorities, the Arts Councils for Scotland, Wales and Northern Ireland and other bodies.

1.2 The National Lottery etc. Act 1993 designated the Arts Council as the body responsible for distributing the proceeds of the National Lottery to the arts in England. As a result of changes introduced by the National Lottery Act 1998, the Arts Council now receive 13.88 per cent of the proceeds raised for good causes (compared with 16.67 per cent prior to the 1998 Act), which they expected to bring them £240.3 million in financial year 1998-99. They also receive an annual grant-in-aid (£184.6 million in 1998-99) from the Department for Culture, Media and Sport. The Arts Council provide grants to numerous arts organisations, either directly or through other funding bodies such as the ten Regional Arts Boards. The various bodies responsible for distributing lottery funds, and the share of the proceeds each receives, are set out at Appendix 1.

1.3 The arts sector had seen little capital investment for many years and the establishment of the National Lottery and the inclusion of the arts as a ‘good cause’ met a pressing need in that area. The National Lottery has, over a very short period of time, changed the scale and nature of the Arts Council’s operations. It has more than doubled the funds available for distribution to the arts in England (Figure 1) and introduced a new source of capital funding for the arts. From the launch of the

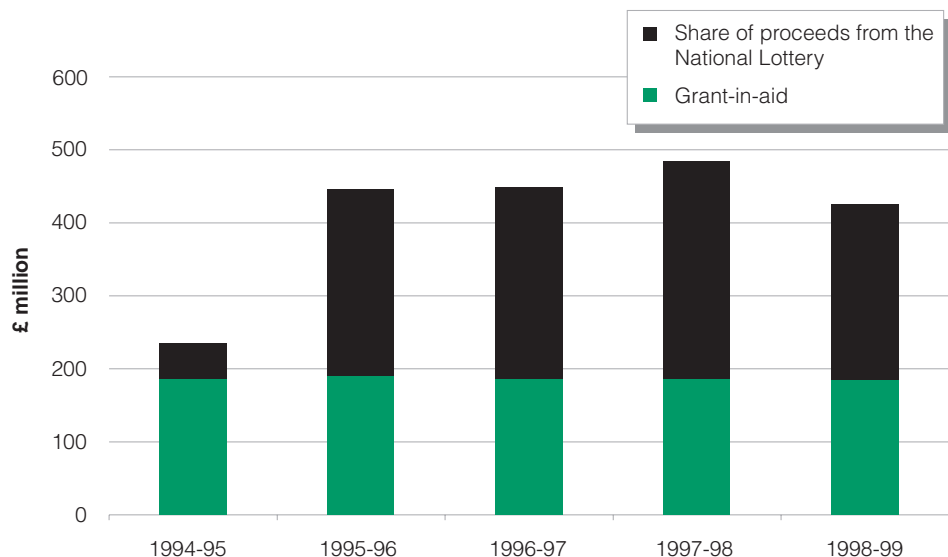
1 The Arts Council of Great Britain were established in 1946. On 1 April 1994 the responsibilities and functions were transferred to three new bodies: the Arts Council of England, the Scottish Arts Council and the Arts Council of Wales. The Arts Council of Northern Ireland were already established as a separate body.

National Lottery in November 1994 to 31 October 1998, the Arts Council's share of lottery proceeds totalled £1,013 million. In awarding lottery grants, the Arts Council also take into account forecast future receipts and during the period in question they made 8,427 awards involving a total commitment of lottery funds amounting to £1,254 million. The organisations supported range in size from major national companies, such as the Royal Opera House, to small local amateur drama groups.

Arts Council grant-in-aid and proceeds from the National Lottery 1994-95 to 1998-99

Figure 1

The introduction of the National Lottery more than doubled the funding distributed to the arts in England



Note: The lower level of proceeds from the National Lottery in 1994-95 reflects the fact that the lottery only commenced operations in November 1994, seven months into the financial year.

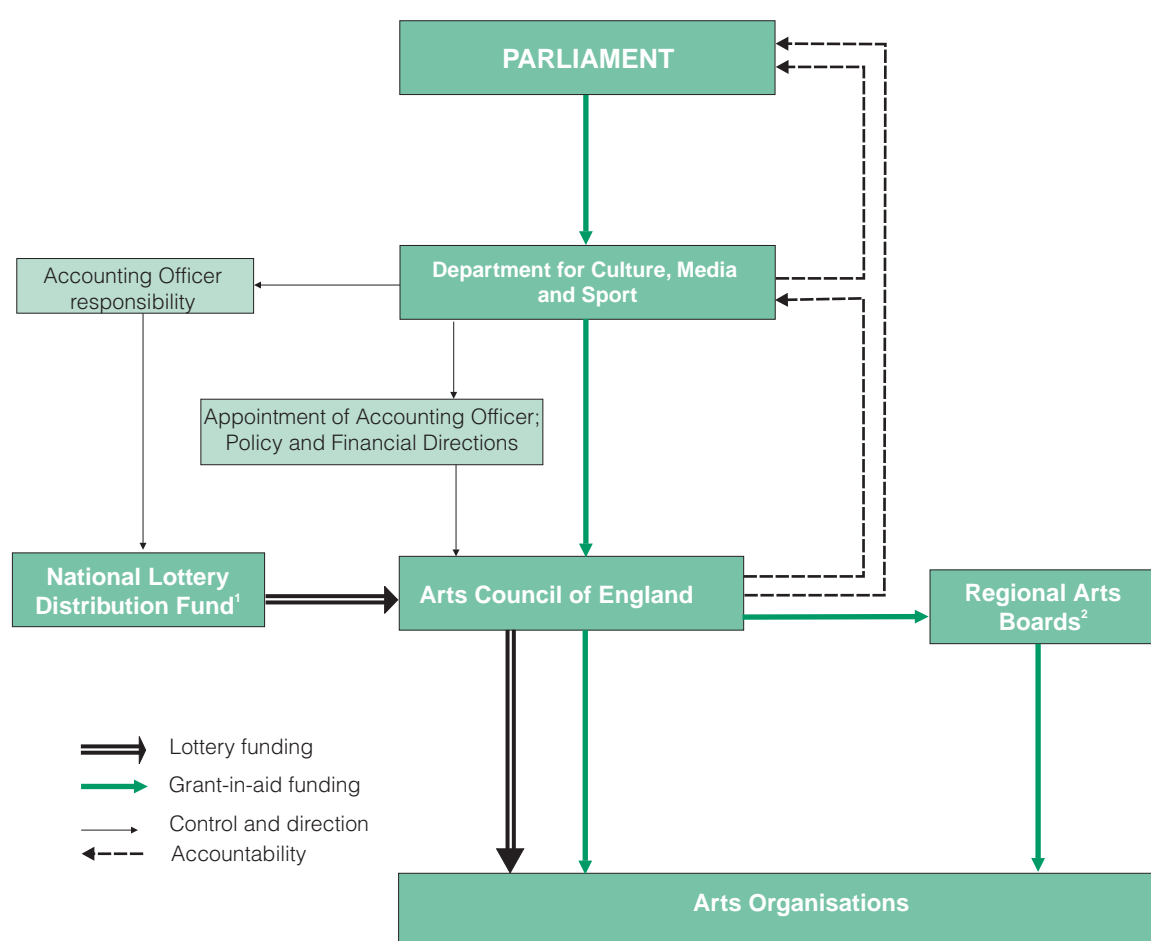
Source: National Audit Office analysis of Arts Council Annual Reports and Accounts

1.4 The arrangements for the funding and accountability of the arts in England are shown diagrammatically at Figure 2. In their role as a lottery distributor, the Arts Council are independent from day to day Government control but operate within a policy and financial framework established by the Department for Culture, Media and Sport. Policy Directions issued to the Arts Council by the Secretary of State in June 1994, and most recently revised in June 1998, set out the factors that the Arts Council should take into account when considering applications for lottery grants (Appendix 2). Financial Directions issued by the

Department in November 1995, and revised in December 1996, set out the broad framework of financial and management controls that the Arts Council are required to establish and with which they have to comply.

Figure 2

Flow of funding, control and direction, and accountability for the arts in England



Notes: 1. The National Lottery Distribution Fund was established under section 21 of the National Lottery etc. Act 1993 to receive monies generated by the National Lottery for the good causes, to allocate these to distributing bodies and to invest the funds, until such time as they are drawn down by the bodies for payment to grant recipients and to meet expenses.

2. There are ten Regional Arts Boards who cover the whole of England and receive about 30 per cent of the Arts Council's grant-in-aid. The Arts Boards allocate these funds to arts organisations that have a predominantly regional remit, and arts projects and initiatives that are based in a particular region. The Arts Council and the Boards are all constitutionally independent from one another although, in practice, their roles are complementary and interdependent.

1.5 The organisation of the Arts Council was changed in June 1998. The governing body (known as the Council) now comprises ten members, drawn mainly from the arts world, plus the Chairman who took up post in May 1998. A sub-committee of the Council, the Lottery Advisory Panel, is responsible for reviewing assessments of applications for lottery grants and for making recommendations to the Council. The Council is responsible, inter alia, for making the decision as to which applications to support. The Arts Council's Chief Executive, in post since March 1998, is the designated Accounting Officer. The organisation structure and main responsibilities, as at 30 June 1998, are set out in Figure 3. At this point, the Arts Council had a staff of 279 of whom 85 were employed on National Lottery activities. The Arts Council's organisation and staffing are currently under review.

Arts Council lottery programmes

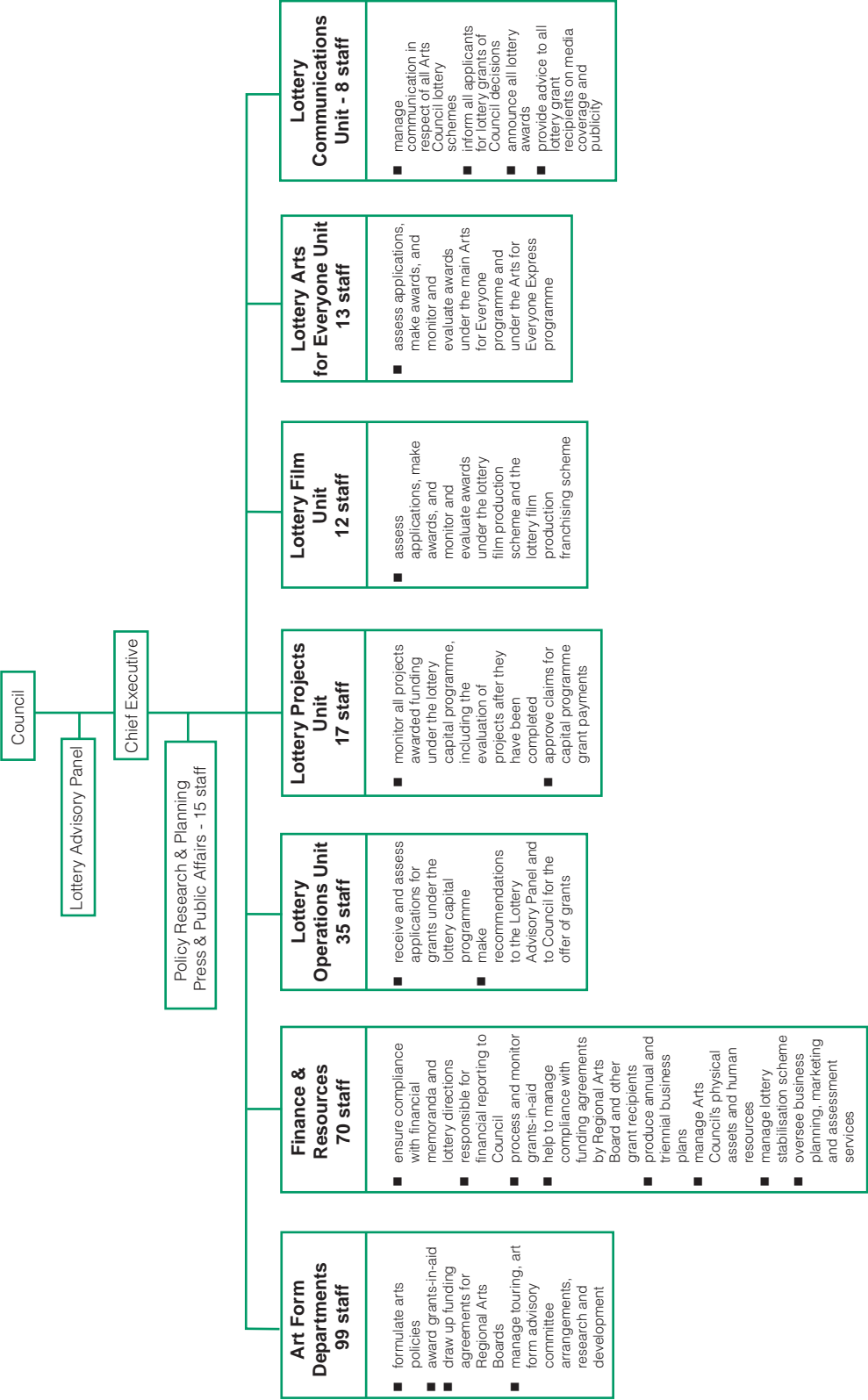
1.6 The Policy Directions issued by the Secretary of State to the Arts Council in June 1994 required the Arts Council to distribute lottery funding for capital expenditure on projects. Such projects include new buildings and building improvements; the purchase of equipment, musical instruments, vehicles, public art and other capital items; and film production. In April 1996, the Department amended the Policy Directions to allow the Arts Council to introduce certain supplementary schemes involving revenue expenditure.

1.7 The first capital programme grants were announced in March 1995. Since then, four other programmes have been introduced. Figure 4 on page 14 gives a brief description of each programme, along with details of the number and value of awards made under each programme as at 31 October 1998. The cost to the Arts Council of administering the distribution of lottery funds has increased each year, as the task has developed, and stood at £22.9 million in financial year 1997-98. This was equivalent to seven per cent of the total value of lottery awards made by the Arts Council in 1997-98.

Figure 3

Organisation structure of the Arts Council of England as at 30 June 1998

This shows the main activities undertaken by each of the Arts Council's departments



Note: Staff numbers are for full time equivalent staff i.e. permanent staff and fixed term contract staff. They do not include agency staff and consultants. The 279 staff employed by the Arts Council includes ten staff employed in the Chairman's Office and the Secretariat (including the Chief Executive and Deputy Chief Executive).

Source: Arts Council

Arts Council lottery programmes

Figure 4

80 per cent, by value, of the Arts Council's lottery grants up to 31 October 1998 have been made under their main capital programme

Lottery programme	Number of grants	Value of grants (£m)	Percentage by value
Capital: First grants made March 1995. Grants for building projects, equipment, musical instruments, public art, vehicles and other capital items.	2,055	1,009	80
Film production: First grants made April 1995. Grants for cinema film production and to artists working with film and video.	107	51	12
Three film franchises were awarded in May 1997 for a period of six years.	3	96	
Stabilisation: First grants made September 1996. Pilot scheme to enable arts organisations to put themselves on a more secure creative and financial footing.	16	28	2
Arts for everyone (A4E): First grants made May 1997. Revenue grants for time-limited projects aimed at developing interest and participation in the arts, especially among young people, and at supporting new work.	5,662	68	5
Dance and drama: First grants made for academic year 1997-98. Assistance to students with tuition fees for certain accredited courses.	584 ¹	2	1
Total	8,427	1,254	100

Source: Arts Council grants database as at 31 October 1998

Note: 1. This figure represents the number of students assisted

The capital programme

1.8 The main capital programme is by far the largest of the Arts Council's lottery programmes. Grants have been made to a wide range of organisations, including registered charities, local authorities, schools, colleges and universities, amateur and voluntary groups and public sector agencies. The types of projects vary considerably; grants made by the Arts Council have ranged from £5,200 towards the purchase of a piano by a local choral society to £78.5 million towards the restoration, refurbishment and extension of the Royal Opera House, Covent Garden. Grants are not normally given for less than £5,000. An analysis of grants, by value, under the capital programme as at 31 October 1998 is at Figure 5. This

shows that £513 million, half the total amount awarded by the Arts Council under the capital programme up to 31 October 1998, has been allocated to 28 large scale projects, each with a grant of over £5 million.

Analysis of capital
programme grants
by value

Figure 5

While 76 per cent of capital programme grants were for less than £100,000, half of the funds awarded under the programme have gone to a small number of projects each awarded over £5 million

Value of grant	Number of grants	Percentage of all grants	Total value of grants (£m)	Percentage of total value of grants
£5,000 to £100,000	1,553	76	70	7
£100,000 to £1 million	351	17	168	17
Over £1 million and up to £5 million	122	6	258	25
Over £5 million	29 ¹	1	513	51
Total	2,055	100	1,009	100

Source: Arts Council grants database as at 31 October 1998

Note: 1. The number of projects actually involved is 28 because one project (Sadler's Wells Theatre) received two grants, each in excess of £5 million.

1.9 Not all applications are successful, and the number of applications that are received and assessed by the Arts Council is much greater than the numbers in Figure 5 suggest. From the launch of the National Lottery to 31 October 1998, the Arts Council received 3,773 applications for the capital programme, with requests for lottery funding that amounted to some £2.39 billion. Thus, only about half of all applications are successful. The reduced share of proceeds from the National Lottery (paragraph 1.2) will increase the pressure on the capital programme.

1.10 As a result of the National Lottery, the arts sector has seen a huge and unprecedented increase in the number and scale of capital projects. This required the Arts Council to step up their operations to direct and manage what has become the largest ever investment programme for the arts. The Arts Council's first priority was to set up the systems and procedures needed to enable them to receive, process and assess applications. This was done in advance of them receiving applications in early 1995. The Arts Council subsequently developed arrangements for monitoring the progress on projects and to evaluate them once they had been completed. The pre-completion monitoring arrangements were developed during the summer of 1996 and were fully in place by November of that year.

1.11 Large capital projects may take years to complete. Responsibility for the construction of the approved project rests with the grant recipient. They are responsible for the overall management of the project, assisted by their design team and other professional advisers, and for delivering it in accordance with the terms of the lottery award. However, whilst there is considerable experience within the arts sector of managing operational activities, often under severe financial constraints, there is not a similar depth of experience in managing capital projects.

1.12 Although the Arts Council are not responsible for the direct management of the projects they fund, they have a substantial investment in each one and are therefore a major stakeholder. They also have a duty under the Financial Directions to safeguard lottery funds. They must therefore monitor projects to ensure they are properly managed, adequately financed, built to an appropriate standard and deliver the benefits set out when the project was awarded lottery funding. They must also ensure that the problems and risks identified by their monitoring are being addressed properly by the grant recipients. As a matter of policy, therefore, the Arts Council decided to adopt a pro-active approach to monitoring. This involves liaising closely with the grant recipient, being supportive, and intervening as necessary, to ensure obstacles to satisfactory progress are overcome. The successful management of any risks and problems is a major objective for the Arts Council, together with the need to secure good value for money from the use of lottery funds.

1.13 The Policy Directions issued by the Secretary of State (Appendix 2) require capital projects to be supported by a significant element of partnership funding from other sources.² Such funding demonstrates commitment on the part of the local community or potential users of the project. The availability of such funding also helps to spread the impact of the lottery further. The Arts Council's policy is that partnership funding should, as a minimum, be 25 per cent of the total eligible project cost. As well as cash, partnership funding can include 'contributions in kind', such as the donation of land or the provision of professional services free of charge. However, in order to ensure that there is sufficient working capital to deliver the project the Arts Council normally require at least half of the partnership funding to be in cash.

2 The Policy Directions subsequently issued to the Arts Council by the Secretary of State in June 1998 modified this Direction. Whilst projects still require an element of partnership funding, this is to be commensurate with the reasonable ability of applicants to obtain such support.

Independent reviews

1.14 In March 1996, the Department for Culture, Media and Sport commissioned consultants, Ove Arup Partners, to examine each distributor's arrangements for monitoring the progress of projects and to produce a best practice guide to project monitoring. This guide, published in September 1996, set out the basic requirements of an effective monitoring system. The report noted that the distributors took different approaches to monitoring (effectively 'hands on' and 'hands off') and that both approaches could be reconciled with best practice. The consultants noted that the Arts Council exemplified the more pro-active 'hands on' approach.

1.15 In July 1996, the Arts Council commissioned consultants, Adrian Ellis Associates, to review the main capital programme (Appendix 3). They concluded that applicants were getting too involved in detailed design matters at the feasibility stage of a project and were not giving sufficient thought to strategic issues such as the essential purposes of the project. They considered that the quality and appropriateness of building projects could be improved with the introduction of a three-stage application process. The three stages are feasibility study, project development, and construction. These new arrangements were introduced in July 1997 for projects with an estimated total cost of £500,000 or more. The consultants were also concerned about the Arts Council's assessment of an applicant's financial viability and considered that there had been an under-estimation of the demands which planning and managing a large capital project places on arts organisations. A follow-up review, in May 1998, concluded that the Arts Council had made considerable progress in addressing these concerns.

1.16 In June 1998, the Arts Council commissioned consultants, Annabel Jackson Associates, to review their approach to project monitoring (paragraph 2.9 and Appendix 3). Their report, in October 1998, made several recommendations for strengthening the Arts Council's project monitoring and the Arts Council are implementing these. In July 1998, the Arts Council commissioned consultants, Currie & Brown, to review the performance of their Building Monitors (paragraph 2.18).

Select Committee coverage

1.17 The Culture, Media and Sport Committee of the House of Commons (previously the National Heritage Committee) have conducted a number of inquiries involving major lottery projects, in particular the Royal Opera House (funded by the Arts Council) and the Millennium Dome (funded by the Millennium Commission). In their first report on the Royal Opera House (HC 199-I, 1997-98) the Committee expressed concern over the extent of financial control by the Arts Council of lottery grants. The Government's response drew attention to the Arts Council's responsibility to comply with the Financial Directions (covering matters such as appraisal and monitoring) issued by the Department for Culture, Media and Sport. It also noted that this value for money study by the National Audit Office was underway and would include an examination of the lottery award to the Royal Opera House.

Previous coverage by the National Audit Office and Committee of Public Accounts

1.18 This is the second examination by the National Audit Office of a lottery distributing body. The first report, published in March 1998 (HC 617, 1997-98), examined all aspects of the English Sports Council's arrangements for distributing lottery funds, including monitoring the progress and outcome of projects.³ The Committee of Public Accounts, in their report (HC 873, 1997-98), recommended that distributors should ensure that their arrangements for monitoring projects, prior to completion, are adequate in meeting their obligations set out in the Financial Directions in relation to the proper use of the funds provided. They also recommended that a strong line should be taken in cases where the project is not used for the purposes intended and where key issues, such as disabled access, are neglected.

Scope of the examination and methodology

1.19 This study examines how the Arts Council manage the risks associated with the investment of lottery funds in major capital projects. We looked at two specific issues:

- how the Arts Council monitor the progress of major capital projects prior to completion (Part 2); and

³ The English Sports Council was renamed Sport England in February 1999.

- what action the Arts Council have taken when monitoring has identified risks to project objectives, including budgets and timescales, and to the longer term financial viability of the grant recipient (Part 3).

1.20 We were concerned principally with the management of risks during the construction of large capital projects. For this reason we focused our examination on 15 major capital projects, each of which had been awarded a lottery grant of over £5 million and where significant progress had been made in terms of building work completed and grants actually paid. When we commenced our examination only one of the projects had been completed. It was therefore too early to evaluate whether completed projects had delivered the benefits expected when the lottery award was made.

1.21 We examined the Arts Council's project monitoring files for each of the projects to determine how effectively the Arts Council had implemented their project monitoring arrangements. We conducted interviews with the Arts Council's Projects Officers and held a focus group of Arts Council Building Monitors. We also visited each of the 15 projects to look at progress on site and discuss key issues with the project management team. Throughout the report, our findings are illustrated by reference to examples from these projects to demonstrate how the Arts Council have dealt with individual cases. The study methodology is set out in more detail at Appendix 4.

1.22 Each of the 15 projects we examined received an award in the first 18 months of the Arts Council's lottery capital programme. The 15 projects selected for examination, their forecast total cost and level of lottery grant as at 31 October 1998 are shown in Figure 6. Further brief details on each of the projects are set out at the back of this report.

1.23 The lottery support to these 15 projects amounted to £317.7 million, 31 per cent, by value, of all lottery grants by the Arts Council under their capital programme up to 31 October 1998. Figure 7 on page 21 shows the location of all the capital projects awarded grants over £5 million up to 31 October 1998 and highlights the 15 projects that we examined.

**Forecast total project cost
and level of lottery grant
as at 31 October 1998 for
the 15 major capital
projects examined**

Figure 6

Project	Forecast total cost £	Lottery grant £
Royal Opera House, London	214,000,000	78,500,000
Royal Albert Hall, London	66,317,000	20,200,000
Sadler's Wells Theatre, London	52,518,000	36,000,000
Royal National Theatre, London	42,820,000	31,590,000
Royal Academy of Dramatic Art, London	32,428,000	23,746,841
Royal Exchange Theatre, Manchester	31,999,000	23,057,250
Milton Keynes Theatre and Gallery	30,954,000	20,171,485
Royal Court Theatre, London	25,832,000	18,825,850
Victoria Hall & Regent Theatre, Stoke-on-Trent	24,587,000	16,135,000
Shakespeare Globe, London	16,826,000	12,400,000
National Centre for Popular Music, Sheffield	14,977,000	11,085,000
Cambridge Arts Theatre	12,674,000	7,390,000
National Glass Centre, Sunderland	12,562,000	6,901,000
Dovecot Arts Centre, Stockton-on-Tees	9,108,000	6,631,750
Malvern Festival Theatre	6,880,000	5,087,640

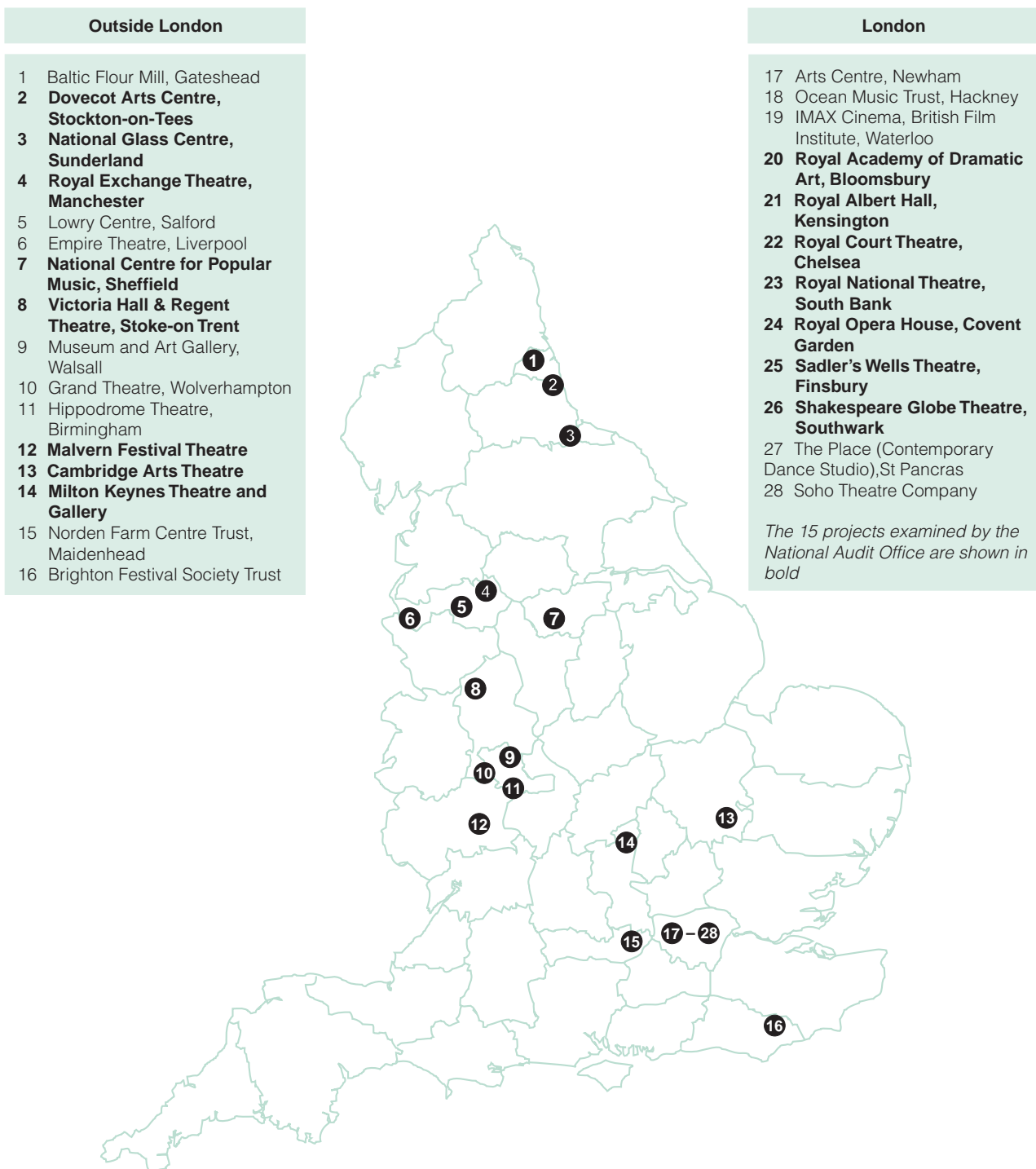
Source: Arts Council grants
database as at 31 October 1998

Note: The Royal Albert Hall project is also receiving funds from the Heritage Lottery Fund.

Figure 7

Projects awarded capital programme lottery grants over £5 million

This shows the location of projects that have been awarded lottery grants totalling more than £5 million from the Arts Council of England's capital programme





The Royal Opera House, London



The National Centre for Popular Music, Sheffield during construction



The inaugural concert in the Victoria Hall, Stoke-on-Trent

The exterior of the Shakespeare Globe Theatre, London

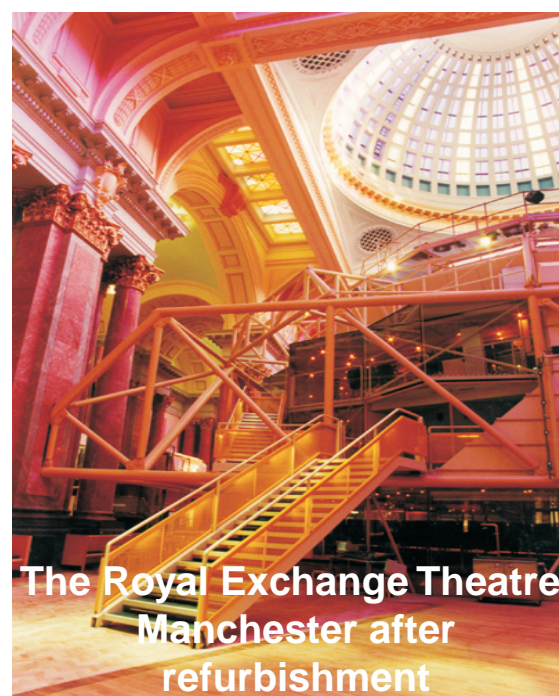


The completed National Centre for Popular Music, Sheffield

The stage of the Shakespeare Globe Theatre, London



Malvern Festival Theatre during construction work



The Royal Exchange Theatre, Manchester after refurbishment



The completed Arc Arts Centre (Dovecot Arts Centre) at night

Part 2: Monitoring the progress of major capital projects

2.1 This part of the Report examines the Arts Council's performance in monitoring the progress of major capital projects funded by the lottery. We examined the key features of their project monitoring arrangements and how these had been operated for each of the 15 projects in Figure 6.

The objectives of project monitoring

2.2 The Financial Directions issued by the Department for Culture, Media and Sport (paragraph 1.4) require the Arts Council to establish project monitoring and evaluation systems, designed to demonstrate that:

- lottery grants are being used for the purposes intended and that the projects supported represent value for money; and
- lottery projects are delivering the benefits identified in the application and in accordance with the specified financial arrangements.

2.3 Under these Directions, the Arts Council are required to institute a system for project monitoring to ensure that there are sufficient monitoring indicators to cover significant risk arising on all capital projects, including construction delays, material changes in specification, and cost overruns. They also require that monitoring of lottery-supported capital projects should be continued after completion once the facility is operational. The Department's consultants (paragraph 1.14) reported that the basic requirements of an effective monitoring system should:

- provide an up-to-date statement of progress and achievement;
- identify problems at the earliest stage; and
- ensure a rapid response to changed circumstances.

The Arts Council's project monitoring arrangements

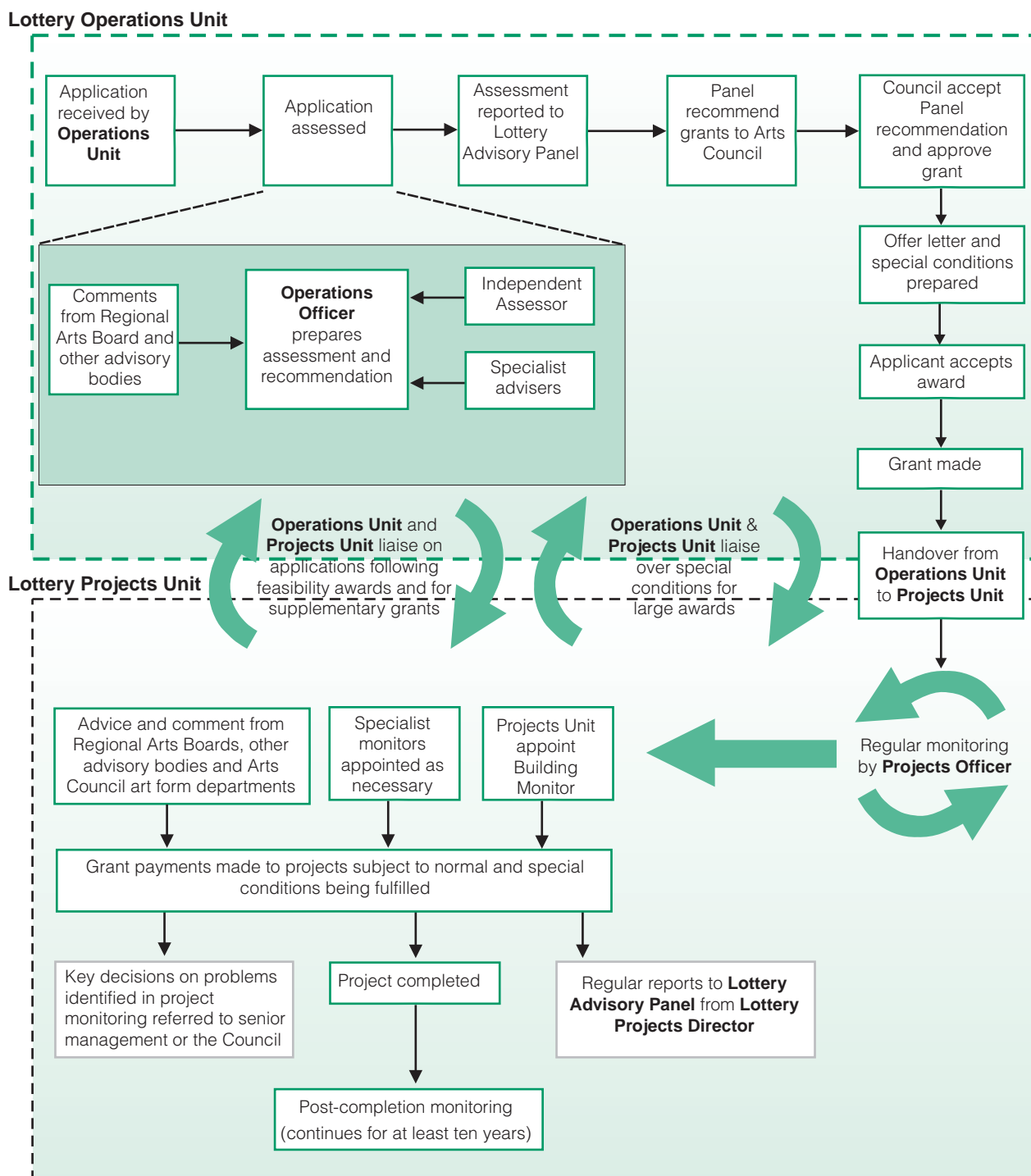
2.4 The Arts Council's project monitoring arrangements have evolved since the launch of the National Lottery in November 1994. Initially, monitoring was undertaken within the Lottery Operations Unit by the same staff that had assessed whether applications for lottery funds should be awarded grants. In April 1996, the Arts Council established a separate Lottery Projects Unit, to be responsible for monitoring the progress of projects, approving the payment of lottery funds, and for the post-completion evaluation of projects. Responsibility for monitoring individual projects passed to this new unit in Autumn 1996. As at 31 October 1998, the Projects Unit comprised a Projects Director and 6.5 Projects Officers, plus nine assistants. Many of these staff have specialist expertise relevant to the monitoring of arts projects, including legal, financial, architectural, project management, arts administration and arts promotion and production skills. Figure 8 sets out how applications made under the Arts Council's capital programme are assessed and monitored, showing the inter-relationship of the Operations Unit and Projects Unit.

2.5 The Projects Officers (within the Lottery Projects Unit) play a pivotal role in the Arts Council's arrangements for the monitoring of projects. They are responsible for co-ordinating the monitoring of individual projects and ensuring that any problems that emerge are properly dealt with. Each Projects Officer oversees around 200 projects of all values, including about five that have awards over £5 million. The procedures to be followed are set out in a comprehensive Project Monitoring Procedures Manual, which was issued in August 1996 and revised in June 1997. The Projects Officer's main duties are summarised in Figure 9 on page 25.

Figure 8

Outline of assessment and monitoring process

This outlines the process a successful project goes through from application to post-completion monitoring



Source: National Audit Office

The main duties of the
Arts Council’s
Projects Officers

Figure 9

Projects Officers undertake a wide range of tasks in co-ordinating the monitoring of individual projects

- Reviewing self-assessment reports
- Appointing independent Building Monitors, specialist monitors and external consultants as necessary
- Ensuring receipt and adequacy of monitoring reports
- Acting on advice from monitors, consultants and others such as Arts Council Art Form departments and Regional Arts Boards
- Liaising with individual project management teams
- Checking and authorising payments of grant
- Ensuring compliance with standard and special grant conditions
- Ensuring projects meet the aims and objectives as stated in the grant application

Source: Arts Council Project
Monitoring Procedures
Manual - June 1997

2.6 The Project Monitoring Procedures Manual states that the main purpose of monitoring during the construction phase of the project and prior to completion (pre-completion monitoring) is to ensure that the project is completed on time, within budget and to the prescribed standard; and that all of the conditions attached to the lottery grant are satisfied. These conditions include standard conditions, which the Arts Council attach to each offer of grant to safeguard their investment of lottery funds, and special conditions, which are designed to cover specific risks associated with individual projects. We considered certain of the Arts Council’s standard conditions to be particularly relevant to the issues examined by this study and these are set out in Figure 10.

2.7 The Project Monitoring Procedures Manual states that the purpose of post-completion monitoring is to ensure that projects are delivering the benefits identified in the original application and in accordance with the specified financial arrangements; and that the assets purchased under the project are being used for the purpose for which they were intended.

Relevant standard conditions applied by the Arts Council to lottery capital programme grants

Figure 10

The grant must be used for the purpose set out in the approved application and is non-transferable. The grant may have to be repaid in full or in part if there is a change of purpose or ownership, either during the project or within a reasonable period of its completion.

The grant recipient must supply the Arts Council with regular progress reports on the project and with any further financial or other information that may be required by the Arts Council to monitor their lottery expenditure.

The grant recipient shall take steps to monitor the success of the project and provide the Arts Council with any information they require to satisfy themselves that the project has been completed properly and in accordance with these conditions.

The lottery grant shall become repayable to the Arts Council, and any future payments stopped, where the grant recipient:

- ceases to operate, is declared bankrupt or placed into receivership or liquidation;
- fails to apply the grant for the purposes for which it was obtained, or fails to complete the project;
- fails to comply with the conditions of grant; or
- has acted fraudulently or negligently at any time during the completion of the project.

The grant will not be increased in the event of an overspend on the project. Any variation in the level of support would have to be the subject of a revised application and assessment by the Arts Council.

Source: Arts Council

2.8 The Arts Council tailor the level of monitoring they carry out to the scale of the project. All grant recipients under the capital programme are required to provide the Arts Council with regular progress reports on their projects. In addition, for all projects awarded £100,000 or more, pre-completion monitoring also includes:

- reports by an independent Building Monitor;
- reports by specialist monitors and advisors; and
- reviews by the Arts Council's Business Assessment and Planning team.

2.9 In June 1998, the Arts Council commissioned external consultants, Annabel Jackson Associates, to carry out a review of their monitoring of lottery capital projects (Appendix 3). Their report, in October 1998, noted that the Arts Council have adopted a dynamic, action-oriented approach to monitoring, directed at problem solving and learning. It concluded that this pro-active approach was appropriate, given the kinds of problems experienced by

organisations funded under the Arts Council's lottery capital programme. The report made several recommendations for strengthening the Arts Council's project monitoring, some of which concerned the role of Building Monitors (paragraph 2.10), and the Arts Council are implementing these.

Building Monitors

2.10 Since mid-1995, the Arts Council have obtained independent advice on the progress of lottery funded projects. These independent advisers, the Building Monitors, are mostly professional project managers or quantity surveyors. The Arts Council maintain an approved list of companies selected to act as Building Monitors and there are currently 15 companies on this list. These companies were selected following competitive tendering in accordance with European Union procedures, most recently in March 1997. Tenders were assessed against the following criteria:

- calibre of personnel;
- arts experience;
- project monitoring experience; and
- project and construction management experience.

The Arts Council negotiated fee rates with the chosen companies by reference to the experience of each individual monitor and succeeded in reducing fees in some cases by half the amount tendered. Building Monitors are engaged on a daily basis for which the fee is normally around £400. The National Audit Office's focus group of Building Monitors and the Annabel Jackson Associates review (paragraph 2.9) stressed the need for Building Monitors to be appointed as early as possible in the lifetime of a project.

2.11 Building Monitors are appointed to projects on an individual basis from the list of 15 companies. Monitors are employed under a standard contract that details their terms of reference. The Arts Council's Projects Officer determines the amount of time a Building Monitor should spend monitoring each project. This usually amounts to one or two days per month to meet with the grant recipient's project management team, review progress, and make a report to the relevant Projects Officer. However, larger projects, or more complex stages of development, may require a greater level of involvement. For the 15 projects we examined, the

average level of input was two days per month, with the highest level of input, at eleven days per month, on the Royal Albert Hall. Our focus group of Building Monitors concluded that Building Monitors are often not able to carry out the full range of duties specified by the Arts Council within the time allowed and therefore have to prioritise their monitoring on the key areas for each project. The review by Annabel Jackson Associates (paragraph 2.9) also recommended that the Arts Council's Projects Officers should give additional guidance to Building Monitors on priority areas for individual projects. The Arts Council have accepted and are acting on this recommendation. They also accept the need for flexibility over the time allowed to Building Monitors to carry out their duties in particular cases, depending on the duties involved and on the scale and complexity of the project in question.

2.12 The Building Monitors are the 'eyes and ears' of the Arts Council. They provide Projects Officers with detailed and frequent - usually monthly - reports on all matters relating to design and construction of the building. These reports are made in a standard format determined by the Arts Council, though the level of detail provided varies somewhat depending upon the nature of the project and the stage of construction it is at. The Building Monitor's report includes the following information:

- progress made against the programme for completing the project and the reasons for, and implication of, any delays;
- a comparison between the latest forecast cost and the approved budget, with an analysis of variances;
- the latest projected cashflow (income and expenditure) and analysis of risk areas, including partnership funding;
- a summary of payments made against architect's certificates, approved by the Building Monitor, as a basis for payment of grant;
- details of the types of contracts let, the position on tendering and award of contracts, and any disputes arising;
- commentary and specific concerns on the quality of construction;
- the status of the design brief, the quality and completeness of design information, and departures from the scheme approved by the Arts Council; and
- current and potential problem areas and recommended action.

2.13 For the 15 projects we examined, we reviewed the timeliness of the monitoring carried out by the Building Monitors and analysed the quality of their reporting to the Arts Council. For 12 of the 15 projects, we found that the Building Monitors' reports had provided the Arts Council with the information they needed to be aware of progress against project budgets and target completion dates and that they had identified problems and associated risks. An example of the way in which Building Monitors have kept the Arts Council informed is at case study 1. As a result of the Building Monitor's feedback, the Arts Council were aware that the project was going to be completed late and over budget and knew the reasons for this.

Case study 1 Dovecot Arts Centre, Stockton-on-Tees

The Arts Council's Building Monitor was appointed in January 1997 and over the next nine months drew the Arts Council's attention to significant events affecting the project:

- the forecast project cost had increased above the project budget;
 - the Centre was pursuing savings in later work packages which might affect the quality of the project;
 - inclement weather in June 1997 had delayed completion of the sub-structure work;
 - tenders for the super-structure contract and mechanical and electrical trade packages were higher than budgeted, so using up all the contingency; and
 - the appointment of the same contractor for super-structure and sub-structure work had led to labour shortages and a likely delay of 12 weeks.
-

2.14 However, in three of the 15 cases we examined, we found that the amount, quality, or timeliness of information provided was not fully satisfactory for effective monitoring. In two of these cases, the Building Monitors did not fully satisfy their remit, either because they did not provide sufficient information (case study 2) or because, although they provided the required information to the Arts Council, they did not produce regular written reports (case study 3). However, this did not affect the progress of the projects in question.

Case study 2 National Centre for Popular Music, Sheffield

The original Building Monitor was appointed in October 1995 but his reports to the Arts Council were of a poor quality, provided minimal information and little commentary. Reports were not produced for February and March 1997 because the Building Monitor considered the project to be on hold, pending approval of a supplementary grant. In fact, the Arts Council offered a supplementary grant on 4 February 1997. The Arts Council replaced him with a new Building Monitor in April 1997.

Case study 3 Malvern Festival Theatre

The Building Monitor was appointed in December 1996 and maintained close contact with the grant recipient's project management team and the Arts Council's Projects Officer. The Projects Officer also received regular reports from the project management team. The Arts Council considered the Building Monitor to be highly effective in many respects (making monthly visits to the site, checking all documentation in connection with claims for payment of grant and conferring on the telephone with the Projects Officer on a regular basis). However, he had to be pressed to produce a full, written progress report, despite the project experiencing some problems. The first report was received in October 1997, some ten months after the Building Monitor was appointed, and was followed by a second, briefer report in February 1998. The project was completed almost on time and within budget in March 1998.

2.15 In one other case, the Building Monitor experienced difficulties in obtaining essential information from the grant recipient (case study 4). The Arts Council acknowledged that they were fully aware of the Building Monitor's difficulties and accept that they could have intervened earlier than they did with a formal written warning to the grant recipient about the non-delivery of information, though they pointed out that the grant recipient was not seeking to draw down any of the grant at that stage. The project came under much closer scrutiny when, due to unforeseen events, the grant recipient had to return to the Arts Council for a supplementary grant in June 1997. The Arts Council were concerned to ensure that there were effective arrangements for the management of the project and attached special conditions to the supplementary grant which sought to achieve this.

Case study 4 **Victoria Hall & Regent Theatre, Stoke-on-Trent**

From the outset, in September 1996, the Building Monitor was unable to obtain some of the information he required from the grant recipient. The Building Monitor started chasing the grant recipient in November 1996 and copies of his faxes and letters were sent to the Arts Council. However, it was not until April 1997, some five months later, that the Building Monitor confirmed that he had the information needed to compile a report for the Arts Council. The Arts Council did not take any formal direct action, mainly because they were not being asked to pay out any of the grant during this period. The first payment of lottery grant was made in September 1997. Nevertheless, the project was proceeding, albeit with financing from partnership funds.

Around this time the project encountered some problems - ancient mine workings were discovered beneath one of the sites and, in a separate incident, the demolition contractor refused to carry out underpinning work within the price agreed. This resulted in a cost increase and the Arts Council made a supplementary award in July 1997. The Arts Council attached special conditions to this award which sought to ensure that there were effective arrangements for the management of the project.

The Building Monitor submitted his first report to the Arts Council in November 1997, but even then he expressed reservations about the extent and quality of some of the information provided.

2.16 The reports and feedback provided by Building Monitors are central to the process of monitoring projects. Whatever the cause, a failure in this part of the monitoring mechanism means that the Arts Council do not have the information they require about progress (or lack of it) on projects. Likewise, a Building Monitor's inability to obtain timely information from the grant recipient means that the reports submitted will be based on information that is out of date and, possibly, unreliable. In the event of a cost overrun, there is also the risk that the overrun may be greater than whatever figures are available suggest, with ramifications for the financial viability and value for money of the project. And the lack of adequate and reliable information might itself be an indication of more serious problems surrounding the management of the project. Without reliable and timely information the Arts Council are exposed to risk, poorly placed to respond when problems arise, and unable properly to determine an appropriate course of action.

2.17 The Arts Council have taken various steps to ensure that Building Monitors carry out their duties to a high professional standard. In March 1997, the Arts Council reviewed the terms of reference for Building Monitors. They

introduced a more definitive statement of the tasks required within a tauter contract and also required all Building Monitors to undergo training in connection with their lottery work. This training was repeated in November 1998.

2.18 In July 1998, the Arts Council commissioned external consultants, Currie & Brown, to review the overall performance of each of the 15 companies on the Arts Council's approved list. The Arts Council propose to use the results of the exercise to inform the future appointment of Building Monitors. The consultants' report, in September 1998, also made several recommendations aimed at improving the standard of reporting to the Arts Council. These recommendations included making the payment of Building Monitors' fees conditional upon the Arts Council's receipt of their reports and improving the standard form of report to include an executive summary. The consultants also identified the need for additional training and proposed a regular forum of Building Monitors and Arts Council Projects Officers to discuss monitoring issues. This proposal was supported by Building Monitors at the focus group held by the National Audit Office. As at 31 October 1998, the Arts Council were implementing the report's recommendations.

Specialist monitors

2.19 The Arts Council appoint specialist monitors to focus on aspects of a project outside the normal skill and expertise of the Building Monitor. Specialist monitors are appointed at the outset of a project or brought in as particular issues arise, in which case they might also advise the Arts Council on how best to proceed (paragraphs 3.7 to 3.8). The Arts Council had appointed one or more specialist monitors for five of the 15 projects we examined. In some cases, specialists were appointed to provide particular technical expertise; for example, in respect of the broadcasting facilities at the Royal Opera House, and the potential effect of restoration work on the acoustics at the Royal Albert Hall. In other cases, they were appointed to address the Arts Council's concerns about the financial position and management of the project; for instance, partnership funding at the Royal Academy of Dramatic Art. Figure 11 shows the five projects with specialist monitors and advisers and the reason for their appointment.

Projects where the Arts Council have appointed specialist monitors and advisers

Figure 11

Project	Reason for appointment
Cambridge Arts Theatre	To assess and monitor Cambridge Arts Theatre Trust's financial position.
Royal Academy of Dramatic Art, London	To review the Academy's financial position and to monitor their progress in raising partnership funding. Also, to monitor the progress of the Academy's Disability Working Party.
Royal Albert Hall, London	To advise on heritage issues, acoustics and building services.
Royal Court Theatre, London	To review progress in meeting the conditions relating to design and construction aspects of the project; and in connection with the financial options, operational plans and partnership funding.
Royal Opera House, London	To carry out independent financial analysis of information provided by the Royal Opera House in connection with their fulfilment of certain special conditions and to advise on a range of construction, technical, legal and broadcast issues.

Source: National Audit Office analysis

2.20 We found that, in these five cases, specialist monitors and advisers have provided the Arts Council with valuable expertise for aspects of a project that are either complex or have been identified as needing close attention. The input provided by these monitors and advisers has supplemented the work of the Building Monitor in providing the Arts Council with an assessment of a project's progress. For example, in May 1998 the specialist financial monitor for the Royal Academy of Dramatic Art project highlighted the need for radical action in connection with the Academy's financing of the project and in relation to its operating deficits. The Arts Council subsequently asked the Academy to develop radical proposals to address the problems (paragraph 3.29).

Cost of independent monitoring

2.21 For each of the 15 projects, we identified the amounts paid by the Arts Council to Building Monitors and specialist monitors and advisers (from the commencement of independent monitoring in mid-1995 to 31 October 1998) and compared this with the total amount of lottery grant paid during this period. The amounts include the cost of 'trouble-shooters' and special advisers brought in by the Arts Council to assist them in dealing with problems (paragraphs 3.7 to 3.8),

but exclude the cost of monitoring carried out within the Arts Council. Figure 12 shows that the cost of external monitoring averaged 0.23 per cent of total grant paid and varied between 0.67 per cent and 0.07 per cent. The key factor for this variation is the complexity of the project and problems associated with it. The Arts Council consider that their external monitoring costs compare favourably with levels that apply in the private sector, where monitoring fees can reach one per cent of total project cost.

Figure 12**Expenditure on external project monitoring compared with grant paid as at 31 October 1998**

External project monitoring costs vary between 0.67 per cent and 0.07 per cent of grant paid

Project	Lottery award £	Grant paid £	Building Monitor cost £	Specialist monitor cost £	Monitoring costs as a percentage of grant paid %
Royal Academy of Dramatic Art	23,746,841	10,007,700	50,400	16,500	0.67
Royal Albert Hall	20,200,000	5,926,100	23,700	5,500	0.49
Cambridge Arts Theatre	7,390,000	7,187,400	8,100	19,300	0.38
Royal Court Theatre	18,825,850	10,934,400	20,300	11,700	0.29
National Glass Centre	6,901,000	6,889,500	20,000		0.29
Dovecot Arts Centre	6,631,750	5,451,600	11,600		0.21
Milton Keynes Theatre and Gallery	20,171,485	13,571,600	20,400		0.15
Sadler's Wells Theatre	36,000,000	32,559,100	48,700		0.15
National Centre for Popular Music	11,085,000	7,059,800	10,500		0.15
Royal Opera House	78,500,000	67,697,000	62,100	31,500	0.14
Malvern Festival Theatre	5,087,640	4,973,600	6,600		0.13
Royal Exchange Theatre	23,057,250	19,096,400	21,400		0.11
Victoria Hall & Regent Theatre	16,135,000	10,947,800	11,500		0.11
Royal National Theatre	31,590,000	18,034,200	15,100		0.08
Shakespeare Globe	12,400,000	11,450,000	8,000		0.07
Average					0.23

Source: Arts Council

Business Assessment and Planning team

2.22 The Lottery Projects Unit may also call on specialist advice from elsewhere within the Arts Council and, in particular, the Arts Council's Business Assessment and Planning team. This team was set up to ensure adoption of effective, efficient and appropriate business practices by subsidised arts organisations. Originally, the team worked on the appraisal of organisations funded by the Arts Council from

grant-in-aid. When the National Lottery was introduced, the team worked with staff in the Lottery Operations Unit to try to develop appropriate techniques for assessing the impact on organisations of large capital projects. The Arts Council considered the ability of arts organisations to manage large capital projects to be one of the main risks to their lottery capital programme.

2.23 Projects Officers had called in the Business Assessment and Planning team to carry out one-off reviews of three of the 15 projects we examined. We analysed the results of the reviews carried out by the team, in the light of the brief they were given, and found that, in two of the three cases, there were serious deficiencies in the reports produced (case studies 5 and 6).

Case study 5 Royal Court Theatre, London

Monitoring pointed to the project falling short of its required 25 per cent partnership funding, resulting in a cashflow deficit for about 12 months during the construction phase. The Business Assessment and Planning team were asked to advise the Projects Officer whether the deficit could be avoided and whether partnership funding was likely to be raised before major contracts were let. The Business Assessment and Planning team described the fund-raising strategy as 'perfectly plausible' and claimed that the Projects Officer was wrong to base partnership funding assumptions on a worst case scenario (the major donation not being received until January 1998), arguing that the donation was likely to materialise in 1997. However, even when the Projects Officer used the more optimistic assumptions advocated by the Business Assessment and Planning team and re-worked the cashflow schedule, it still resulted in a deficit. The major donation had still not materialised by October 1998, by which time the grant recipient had secured financial support from a different organisation.

Case study 6 Cambridge Arts Theatre

The Business Assessment and Planning team undertook a post-completion review of the project and reported in April 1997. The review identified that the lottery project had left the grant recipient with a deficit of £1.1 million but did not highlight the serious financial difficulties that the grant recipient was then in. Although they are standard parts of the report, the team did not comment on the existing financial position, with reference to the latest company and management accounts, or the future position, as indicated by budgets and cash flow forecasts. Although this was mainly because the grant recipient was already in crisis and did not have all the information relating to its true financial position until some time later, the Business Assessment and Planning team failed to highlight this. In June 1997, the grant recipient applied to the Arts Council for help to overcome its financial crisis.

2.24 These case studies suggest that the reviews carried out by the Business Assessment and Planning team were not sufficiently thorough and that the level of financial analysis carried out failed to reveal serious underlying problems. They provided an incomplete service and an unsound basis for decisions by Projects Officers. In particular, their description of the Royal Court Theatre's fund-raising strategy as 'perfectly plausible' did not properly recognise the risk of non-payment of a major donation that, at that time, amounted to some 60 per cent of the partnership funding needed to complete the project.

2.25 The Arts Council told us that they had used the services of their Business Assessment and Planning team on a 'pilot' basis. When it became clear that the team were unable to provide the standard of assistance required, they turned increasingly to external consultants. The Annabel Jackson review of the Arts Council's project monitoring (paragraph 2.9) also concluded that the Business Assessment and Planning function needed strengthening. The review recommended that the reports should focus more on financial viability and management issues. The Arts Council are currently reviewing their arrangements for drawing on specialist financial expertise and are considering the future role of their Business Assessment and Planning function in this respect. Their aim is to strengthen the function significantly, including an increased complement of professionally qualified and experienced staff.

Co-ordination of monitoring

2.26 As described in paragraph 2.5, the Projects Officer plays a pivotal role in the project monitoring arrangements. If the Projects Officer does not have a complete overview of a project, the strengths of this role are undermined. For one of the projects we examined, the Royal Opera House, we found that different people had primary responsibility for monitoring different aspects of the project. For example, for five months during 1996, an external adviser monitored the Royal Opera House's fundraising and financial planning and reported direct to the then Secretary General. A second specialist was appointed in January 1998 with day-to-day responsibility for monitoring the Royal Opera House's financial position (grant-in-aid and lottery grant). In parallel with these arrangements, the Projects Officer continued to monitor the various financial and non-financial aspects of the project, but did not have full information on the Royal Opera House's progress in raising partnership funding. The Arts Council told us that this financial information is now more readily available to the Projects Officer (case study 7).

Case study 7 Royal Opera House, London

In July 1995, the Arts Council awarded a first tranche of £55 million of a total grant of £78.5 million towards the cost of the £214 million Royal Opera House project.

The Building Monitor analysed and reported progress on design, procurement, construction, and performance against time and budget. However, he had no responsibility for checking fulfilment of the special conditions attached to the lottery grant and for partnership funding. Senior officers within the Arts Council, outside of the Lottery Projects Unit, dealt with these issues.

In April 1996, the Arts Council appointed an external adviser, reporting to the Arts Council's then Secretary General, on the Royal Opera House's progress in fulfilling the special conditions and on their financial forecasts and financial systems and management. These reports were completed in September 1996. In November 1996, the adviser was asked to produce a further report on financial developments at the Royal Opera House.

In early 1997, a joint Arts Council/Royal Opera House monitoring group (set up in 1993 for an exchange of views on the financial and artistic performance of the Royal Opera House) became involved in considering whether the Royal Opera House had fulfilled several of the special conditions, including that relating to the programme of activity during closure. The Projects Officer appointed external consultants (Price Waterhouse) in March 1997 to undertake an independent financial analysis of the figures produced by the Royal Opera House. The Projects Officer reported to the monitoring group on progress in meeting these special conditions and on outstanding risk. When the joint monitoring group confirmed that certain special conditions had been satisfied, the Arts Council, taking account also of the independent analysis, approved the award of the second tranche of lottery money of £23.5 million in March 1997. The joint monitoring group no longer meets.

In late 1997 and early 1998 the Royal Opera House experienced serious financial difficulties. In January 1998, an external financial specialist was given day to day responsibility for monitoring the financial position of the Royal Opera House in respect of both the annual grant-in-aid and the lottery grant, including fulfilment of the special conditions. This officer provides weekly reports to the Arts Council's Chief Executive, with a copy to the Lottery Projects Unit.

Despite a partnership funding target of £136.2 million, of which £100 million is to be met by fundraising, the Arts Council were unable to obtain as much detailed information about partnership funding as they required. The Royal Opera House copied to the Arts Council the information they provided on fundraising to Sir Richard Eyre, as part of the review of lyric theatre in London commissioned by the Secretary of State for Culture, Media and Sport. In addition, the Royal Opera House have provided the Arts Council with reports of the progress being made towards the fundraising target, but these give little assurance as to whether this private funding has been or will be secured.

2.27 The various different lines of reporting and possible inequality of information, along with:

- reticence on the part of the Royal Opera House to provide information on partnership funding; and
- an inability on the part of the Royal Opera House to provide financial, operational and programming information

might have weakened the role of the Projects Officer and their ability to monitor the project. However, the Arts Council believe that it was necessary and appropriate to appoint various additional advisers, with some of them reporting directly to senior management, and that these arrangements served to strengthen their overall monitoring of the project.

The outcome of project monitoring

2.28 A key risk with any construction of a large and complex capital project is that it may run into problems which result in cost overruns and delays. The Arts Council's project monitoring seeks to ensure that they are aware of:

- progress against time and budget on projects, and
- problems experienced by projects.

2.29 Most of the 15 projects we examined had experienced problems that resulted in delays and increased costs, though in six cases the cost increase was less than five per cent of the original budget. The progress of each project against its original budget and scheduled completion date is set out in Figure 13.

Figure 13

Actual or forecast outturn against original budget and completion date for each project as at 31 October 1998

12 of the 15 projects we examined were over budget and only eight of the 15 are likely to be completed on schedule

Project	Latest forecast cost £000	Forecast increase on original budget £000	Percentage increase on original budget	Current forecast completion date	Forecast delay against original completion date months
Sadler's Wells Theatre	52,518	14,167	36.9	Sept 2001 ¹	
Royal Court Theatre	25,832	4,761	22.6	June 1999	13
Royal Albert Hall	66,317	8,637	15.0	Dec 2003	
Dovecot Arts Centre	9,108	1,118	14.0	Dec 1998	4
Cambridge Arts Theatre	12,674	1,280 ²	11.2	Dec 1996	1 ²
Milton Keynes Theatre and Gallery	30,954	2,852	10.1	June 1999	
Victoria Hall & Regent Theatre	24,587	1,829	8.0	May 1999 ¹	9
Royal Academy of Dramatic Art	32,428	1,666	5.4	Sept 2001 ¹	12
National Glass Centre	12,562	628 ²	5.3	June 1998	12 ²
Royal Exchange Theatre	31,999	1,256	4.1	Nov 1998	
Royal National Theatre	42,820	700	1.7	Mar 2000 ¹	
Malvern Festival Theatre	6,880	42 ²	0.6	Mar 1998	1
Royal Opera House	214,000			Dec 1999	
Shakespeare Globe	16,826			Oct 2000 ¹	
National Centre for Popular Music	14,977	-278 ²	-1.8	Mar 1999	

Notes: 1. The project comprises several distinct phases and the date shown is for completion of the final phase

2. Actual increase shown where the project has been completed

Source : National Audit Office analysis of Arts Council project files

2.30 Each of the projects had experienced some kind of problem during the construction phase. Some of these were unforeseeable when work commenced and stem from circumstances beyond the control of either the grant recipient or the Arts Council (case study 8). Other problems have arisen that are more directly associated with the way in which work has been carried out and co-ordinated (case studies 9 and 10).

Case study 8 Royal Exchange Theatre, Manchester

Building work uncovered a well beneath a stairway, which needed preliminary archaeological investigation (it proved to be Victorian). The discovery necessitated further design work as well as the physical re-covering and reinstatement of the stairway. Any delay to work involving the stairway would create problems in accessing some parts of the building and delay work in those areas too. By December 1997, work on the stairway was ten weeks behind the original programme, though re-scheduling other work meant that the project still achieved its target completion date of November 1998.

Case study 9 Royal Court Theatre, London

In early 1996, the construction manager responsible for overseeing the appointment of the various trade contractors and co-ordinating their work packages drew up a master works programme for the project of 85 weeks, with completion scheduled for May 1998. However, protracted lease negotiations led to a delay of 24 weeks and put back the completion date to November 1998.

It subsequently became clear that the master works programme did not allow sufficient time for completion of the structural works package agreed with the structural contractor. In addition, the restrictive nature of the site and poor foundations resulted in the structural works taking 13 weeks longer than expected. In July 1997, the construction manager informed the grant recipient that the master works programme was not achievable. The grant recipient subsequently agreed to a revised programme, with completion scheduled for May 1999, one year later than originally planned.

Case study 10 National Glass Centre, Sunderland

Shortly after winning the groundwork contract, several of the contractor's specialist staff resigned. Consequently, the contractor lacked the necessary degree of expertise to carry out the work. Originally planned to take 12 weeks, with completion in January 1997, the work took 30 weeks and the contractor had to return in September 1997 to remedy defects. The main contractor suffered consequential delay and had to correct inaccurate or inadequate work by the groundwork contractor. This has led to claims from the main contractor for costs due to this delay and for the extra and remedial work carried out by them. These claims are the responsibility of a third party and will not impact on the level of lottery funding required.

2.31 We found that, with the exception of the three projects mentioned in paragraphs 2.14 to 2.15, the Arts Council were well aware of the progress of projects and of any problems they had experienced. Whatever the nature of these problems, it is important that the Arts Council should respond appropriately, promptly and effectively to them. The way the Arts Council have done this is examined in Part 3.

Key Findings

2.32 The Arts Council's arrangements for monitoring the progress of lottery funded projects have evolved since the launch of the National Lottery. Greater emphasis was given to project monitoring in 1996, with the appointment of a Lottery Projects Director and the introduction of a new team, the Lottery Projects Unit, with sole responsibility for monitoring. The Arts Council also draw on the advice of independent Building Monitors and specialists on artistic, financial and technical matters.

2.33 The Building Monitors are the 'eyes and ears' of the Arts Council and they have generally provided them with the information they need to assess the progress of projects and to identify problems and associated risks, and this has provided a sound basis for effective monitoring by the Arts Council.

2.34 However, for three of the 15 projects we examined, the amount, timeliness or quality of information provided was not fully satisfactory for effective monitoring. One Building Monitor who failed to provide adequate reports was removed by the Arts Council some 18 months after his appointment. In another case, the Building Monitor experienced difficulty in obtaining up to date and reliable information from the grant recipient. The Arts Council were fully aware of the Building Monitor's difficulties, and accept that they could have intervened earlier with a written warning to the grant recipient about the non-delivery of information.

2.35 The Arts Council initially requested their Business Assessment and Planning team to carry out special 'ad hoc' reviews of projects where they had concerns about financial viability. The team had carried out reviews for three of the 15 projects we examined, but in two of the three cases these reviews were not sufficiently thorough and failed to identify serious underlying problems.

2.36 The Arts Council's Projects Officers play a pivotal role in the monitoring of projects and should have a complete overview of the project at all times. In one case (the Royal Opera House) monitoring involved various different parties, internal and external, some of whom reported direct to senior management. The Arts Council believe that these arrangements were necessary and strengthened their overall monitoring of the project. But they may also have made the co-ordinating role of the Projects Officer more difficult. Also, the ability of the Lottery Projects Unit to monitor progress on this project may have been weakened because of difficulties the Royal Opera House had in providing sufficient and timely information about their financial viability and progress in meeting partnership funding targets.

2.37 For the 15 projects we examined, the Arts Council's monitoring identified effectively a number of significant problems, including construction delays and cost overruns. As at 31 October 1998, 12 of the 15 projects were forecast to be over budget, six by more than ten per cent, and only eight projects had been, or were scheduled to be, completed on time. Five projects were running more than three months late.

2.38 The 15 projects we examined were some of the earlier projects that the Arts Council had awarded lottery grants. The Arts Council have recognised that some of the problems arising during the construction of these projects are a consequence of inadequate planning at the outset by the applicant. In July 1997, the Arts Council revised their application procedures for large projects to ensure that essential work is carried out at the feasibility and development stages before they award a grant for the main project.

Part 3: Action taken by the Arts Council on problems identified by their project monitoring

3.1 This part of the Report examines how the Arts Council have dealt with problems identified by their project monitoring and whether the action they have taken has been sufficient to address the risks involved and to ensure the successful completion of the projects they have supported with lottery funds. The part considers whether the Arts Council have acted in a timely and decisive manner and examines how they have responded to concerns about the long-term financial viability of grant recipients so as to ensure that the projects they have supported deliver the benefits expected.

How the Arts Council respond to problems

3.2 The management of projects and the resolution of problems rest with the grant recipient. However, the Arts Council have a substantial investment in each of these projects and they recognise that they also have a responsibility to seek to ensure their successful completion. They must ensure that problems and risks identified by their monitoring are being addressed properly by the grant recipient and that any action taken will not compromise unduly the quality of the project.

3.3 If a project is not completed, or is completed but does not deliver the facilities for which lottery funds were awarded, the Arts Council can claw back their lottery grant. This right is set out in the standard terms and conditions attached to each offer of grant (paragraph 2.6). However, the Arts Council recognise that it is too late, at this point, to rectify the problems associated with a project. If the completed project is not able to deliver the benefits expected, there will be no opportunity to correct this. The Arts Council's approach, therefore, is to work closely with the grant recipient to overcome difficulties and to find a way for the project to progress.

3.4 When problems arise, the Arts Council consider four main ways of assisting projects:

- reviewing options for getting the project back on track;
- attaching a 'trouble shooter' or special adviser to the project;

- temporarily relaxing the timing of partnership funding requirements and the associated grant payment arrangements; and
- making a supplementary grant.

The Arts Council told us that, since early 1997, they consider these four ways of assisting projects strictly in the order shown, and only when one is exhausted do they move on to the next. However, several of the projects we examined experienced difficulties in 1996, before this approach had fully evolved. In these cases, the Arts Council had not necessarily considered the options in the order set out above.

(i) Reviewing options for getting the project back on track

3.5 In the event of cost overruns, the Arts Council encourage the grant recipient to look closely at all aspects of the project and assess various possible options for getting the project back on track. This is an intensive process, requiring the approval and close involvement of the Arts Council. The options considered will depend on the particular circumstances, but include identifying scope within the project for cost reductions and for deferring particular components of the project (case study 11). This may, as a means of cutting costs, involve a form of value engineering. This technique involves subjecting the design proposals to systematic review to assess whether aspects of the grant recipient's requirements can be met with a lower specification. Where this results in significant changes to the project, the business case for the project is re-assessed with a view to ensuring that the project will still be able to achieve its original objectives and deliver value for money. The Arts Council also encourage applicants to explore any avenues which might yield extra sources of finance and may insist that project cost increases are met from additional partnership funding (case study 12).

Case study 11 Malvern Festival Theatre

The architects were inexperienced in theatre construction and underestimated the cost of the theatre flytower. Also, the tender bids received for the mechanical and electrical works package were significantly over the budget allowed. This resulted in a projected cost overrun of £450,000 (six per cent of the total project cost). However, with the Arts Council's approval, the theatre limited the overrun to £40,000 by drawing on contingencies, omitting some equipment purchases and negotiating lower professional fees.

Case study 12 Milton Keynes Theatre and Gallery

In February 1996, the Arts Council offered the local authority a grant of £19.7 million towards a total project cost of £28.1 million. In July 1996, the authority approached the Arts Council about the possibility of applying for a further grant of £3.4 million (an extra 17 per cent) due to inadequate provision for inflation and contingencies in the original application and the need to provide a larger art gallery. The Arts Council indicated that they were unlikely to approve such an application. The local authority subsequently revised the cost increase to £1.96 million. They proposed to meet this from additional partnership funding, by doubling their corporate fundraising target from £1 million to £2 million and by acquiring an additional £960,000 from the Commission for the New Towns. Further cost increases have since occurred and the authority applied for a supplementary grant of £750,000 in May 1998. The Arts Council have agreed to a supplementary award of £500,000, which is to be applied only towards the theatre element of the project.

3.6 In both these cases, the Arts Council's approach ensured that the projects were able to progress without significant extra cost to the Arts Council. In the case of Malvern Festival Theatre, the grant recipient identified savings of £410,000 and the eventual cost overrun, at less than one per cent of the original total project cost, was met from additional partnership funding. In the case of Milton Keynes Theatre and Gallery, the grant recipient scaled back the first projected cost increase by over 40 per cent and financed the extra cost through additional partnership funding. Although the Arts Council did later offer a supplementary grant, this was limited to £500,000 (2.5 per cent of the original lottery grant).

(ii) Appointing a 'trouble-shooter' or special adviser

3.7 Where a project gets into difficulties, the Arts Council often appoint a 'trouble shooter', where the precise cause of the problem is unclear, or a special adviser, where the cause of the problem is known but where specialist advice is needed on an appropriate solution. In either case, those appointed work closely with the grant recipient to try to resolve the difficulties in question. They report back to the Arts Council on a frequent basis with advice on progress being made and, if necessary, specific recommendations on what corrective action is required. The Arts Council appointed a 'trouble-shooter' or special adviser on six of the 15 projects we examined (Figure 14).

Figure 14

Reasons for the appointment of ‘trouble shooters’ and special advisers

‘Trouble-shooters’ and special advisers have been appointed to provide different types of assistance

Project	Reason for appointment
	‘Trouble-shooter’
Cambridge Arts Theatre	To assess the financial position of the Theatre and assist in developing a ‘rescue package’.
Royal Court Theatre	To assist the grant recipient’s project management team in programming the construction project through to completion.
	Special adviser
Royal Academy of Dramatic Art	To provide expert assessment of the Academy’s proposal to enter into a lease and leaseback financing arrangement and to consider the wider implications of this on the project and the Academy.
Royal National Theatre	To carry out an independent review of matters concerning partnership funding and to recommend a way forward.
Royal Opera House	To review the Royal Opera House’s procedures for financial management and planning and analyse the budget drawn up for the closure period, including an assessment of the robustness of the budget’s underlying assumptions.
Victoria Hall & Regent Theatre	To provide independent advice to the Arts Council about the progress of the project.

Source: National Audit Office Analysis

3.8 Figure 14 shows that ‘trouble-shooters’ and special advisers have been brought in to deal with a range of problems. For example, work on the Cambridge Arts Theatre was accelerated so it would be complete in time for the 1996 pantomime, but this led to cost increases which, in turn, badly affected the Theatre’s financial viability. The Arts Council appointed a construction programming expert to the Royal Court Theatre project because they were concerned that the grant recipient’s project management team did not have the ability and resources to maintain control over the project programme. We reviewed the role played by the ‘trouble-shooters’ and special advisers on each of these six projects and found that they had provided valuable assistance to the grant recipient and additional assurance for the Arts Council.

(iii) Relaxing partnership funding timing requirements and grant payment arrangements

3.9 The Policy Directions issued to the Arts Council require each project to be supported by a significant amount of partnership funding. The Arts Council’s policy is that this should, as a minimum, be 25 per cent of the total eligible project cost (paragraph 1.13). The Arts Council’s payment arrangements provide for

instalments of the lottery grant to be paid in arrears on production of certified claims. The Arts Council also seek to ensure that the total amount of grant paid in relation to costs incurred does not at any time exceed the proportion of the total lottery grant to the total project cost. For example, if the Arts Council have awarded a grant of 75 per cent of the approved total cost, they normally expect each tranche of expenditure to be funded in the ratio of 75 per cent grant and 25 per cent partnership funds, except where the grant recipient has previously met more than 25 per cent of expenditure from partnership funding.

3.10 Ideally, work on a project should not commence until the partnership funding is in place. However, in the case of the largest projects, with partnership funding requirements ranging from £1.75 million (Malvern Festival Theatre) to £136 million (Royal Opera House), this could delay commencement of the project for several years. It might also hinder the fundraising effort as this is often dependent upon an indication of commitment by the Arts Council and a sign of some visible progress on the project. Realistically, fundraising takes time and pledges and contributions are often received over a period of years. Where partnership funds are not raised in time to meet expenditure on the project, there will be difficulties in financing the project. Where such cash flow problems occur, the Arts Council have to make a judgement about the eventual success of a project achieving its partnership funding target in deciding whether, and to what extent, they should advance lottery funds to sustain progress.

3.11 We found that for four of the 15 projects we examined, the Arts Council had temporarily relaxed the timing of partnership funding requirements and the associated grant payment arrangements in order to assist the grant recipient in overcoming cash flow difficulties. Advancing lottery funds at a faster rate than originally proposed further increases the risk for the Arts Council because, in an increasingly competitive fundraising environment, the grant recipient might not succeed in raising the required amount of partnership funding. In this event, the grant recipient may seek to reduce the scope, and cost, of the project or they may seek further funding from the Arts Council to complete the project. In either case, the Arts Council could end up paying a greater proportion of the cost than they originally envisaged.

3.12 We reviewed the financial position on each of these four projects as at 31 October 1998 to ascertain when the Arts Council expect the ratio of lottery grant to partnership funding to drop back to 75:25 (the ratio approved in the offer of grant). The results of this analysis are set out in Figure 15.

Figure 15

Proposals for achieving approved lottery grant to partnership funding ratio

For each project, the achievement of the approved lottery grant to partnership funding ratio is dependent on sufficient partnership funding being raised

Project	Proposals for achieving required ratio
Royal Academy of Dramatic Art	The Academy submitted a detailed fundraising strategy to the Arts Council in July 1998. This was based on the Arts Council continuing to pay 100 per cent of the development costs until April 1999, when the Academy would begin to contribute 20 per cent from their partnership funds. The Academy will meet all further costs when the Arts Council's grant (less the amount retained for defects etc) is fully paid out in March 2001. The ratio of 75:25 lottery grant to partnership funding is expected to be achieved after 2003.
Royal Court Theatre	The partnership funding cashflow forecast submitted to the Arts Council in October 1998 showed the Theatre making a 25 per cent contribution to project costs from November 1998 onwards. However, the grant recipient was concerned about their ability to meet the fundraising targets for December 1998 and January 1999. The forecast also indicated a need for a further relaxation of the arrangements from February to May 1999, up to an amount of £878,000, in advance of a £3 million partnership funding contribution being received in June 1999. For the project as a whole, the ratio of 75:25 lottery grant to partnership funding is expected to be achieved in June 1999.
Royal National Theatre	The Arts Council advised the grant recipient that the ratio of 75:25 lottery grant to partnership funding for the project had to be achieved and arrangements have now been agreed that will result in the approved ratio being achieved by March 2000.
Sadler's Wells Theatre	The Arts Council are continuing to contribute 85 per cent of the project costs and as a result most of the lottery grant had been paid out by the end of 1998. The 75:25 lottery grant to partnership funding ratio is not expected to be achieved until 2001 or later when additional funding has been raised to pay for elements of the project that have been deferred. In January 1999, the grant recipient arranged a loan of £3 million secured on the Theatre.

Source: National Audit Office and Arts Council analysis

3.13 Figure 15 shows that there is a clear strategy for restoring the balance of lottery grant and partnership funding on two of the four projects within 18 months (from October 1998). However, in each case there remains a significant risk that the grant recipient will not be able to raise the required amount of partnership funding in the timescale envisaged.

(iv) Making a supplementary grant

3.14 The Arts Council's standard conditions of grant state that the Arts Council will not increase a grant in the case of a project overspend. Any increase in the level of support must be the subject of a new application and re-assessment by the Arts Council.

3.15 The Arts Council's policy is only to make a supplementary grant if there is no alternative way of making good the financial shortfall and if they are satisfied that the work remaining to be carried out is essential to the success of the project and will add value. Where the Arts Council make a supplementary grant, their level of support for the project is greater than originally intended. Of the 15 projects we examined, eight had been the subject of an application for a supplementary grant and the Arts Council had approved each of these, though in some cases for an amount below that sought. Figure 16 sets out, for each of these eight projects, the amount sought, the amount awarded in relation to the original grant, and the main reason for the supplementary grant.

Figure 16**Supplementary grants made by the Arts Council**

The total amount of supplementary grants awarded to these eight projects represented an increase of almost 11 per cent over the total amount originally granted

Project	Original grant £	Additional amount sought £	Supplementary grant(s) approved £	Increase over original grant %	Reasons for supplementary grant
Sadler's Wells Theatre	30,000,000	6,000,000	6,000,000	20.0	Higher than anticipated costs for some elements of the project; the cost of meeting the Arts Council's requirements; cost overruns on the main building work
Royal Court Theatre	15,803,505	3,448,725	3,022,345	19.1	Increased project costs
National Glass Centre	5,951,000	950,000	950,000	16.0	Elements that could not be accommodated within the original budget
Cambridge Arts Theatre	6,640,000	960,440	750,000	11.3	Cost of acceleration programme
Victoria Hall & Regent Theatre	14,866,000	1,478,000	1,269,000	8.5	Cost overruns
Dovecot Arts Centre	6,256,750	375,000	375,000	6.0	Higher building costs
Milton Keynes Theatre and Gallery	19,700,000	750,000	500,000	2.5	Cost increases due to inflation and some re-design of the project
Royal Academy of Dramatic Art	23,602,283	1,462,450	144,558	0.6	Costs of unforeseen disturbance agreement relating to the building works and of developing proposals for media facilities
Total	122,819,538	15,424,615	13,010,903	10.6	

Source: National Audit Office analysis of Arts Council project files

3.16 Four projects have received supplementary grants of more than ten per cent of their original grant. Sadler's Wells were awarded £6 million to cover a range of cost increases (case study 13) and the Royal Court Theatre received two separate increases totalling over £3 million, again because of increased project costs (case study 14). The National Glass Centre were awarded £950,000 to cover essential works not included in the original budget (case study 15). Cambridge Arts Theatre received £750,000 to accelerate the works programme and re-open on schedule (case study 16).

Case study 13 Sadler's Wells Theatre, London

In January 1995, the Sadler's Wells Theatre applied for a lottery grant of £21.7 million towards a total project cost of £28.95 million. However, English Heritage refused to approve this scheme and the Arts Council awarded a grant of £1.5 million for further design and development. A fundamental redesign and restructuring of the project was undertaken and in October 1995 the Arts Council awarded their main grant of £28.5 million. This brought the Arts Council's contribution to £30 million towards a revised total project cost of £38.35 million.

Project costs continued to increase, partly because elements of the project turned out to be more expensive than budgeted for and because some items were omitted from the original budget. The Arts Council had also required some additions to the project specification when they made the original award. The grant recipient had planned to raise £4 million from a lease finance deal but this collapsed in August 1997 when the forecast project cost could not be contained within the construction budget. By October 1997, the total project cost had increased to £48 million and the theatre applied for a supplementary grant of £6 million. This was made in March 1998 and brought the total lottery grant to £36 million.

Case study 14 Royal Court Theatre, London

In October 1995, the Arts Council awarded a lottery grant of £15.8 million towards the redevelopment of the Theatre at a total project cost of £21.1 million. However, as more detailed design and development work was completed, the project cost increased. In October 1996, the Arts Council accepted the grant recipient's proposal to omit one element of the project (the Young People's Theatre) and transfer the grant allocated to this (£828,750) to the main theatre redevelopment. The Arts Council also awarded a supplementary grant of £477,000 towards the capital cost of the redevelopment and agreed to allow up to £2.3 million of the total lottery grant to be used on closure costs.

Serious delays in completing the project, partly due to poor programming by the construction management contractor, have increased costs further. In July 1998, the Arts Council awarded a second supplementary grant of £2.5 million towards the additional capital and closure costs. The total project cost now stands at £25.8 million and the Arts Council's lottery grant represents £18.8 million of this.

Case study 15 National Glass Centre, Sunderland

The Arts Council awarded a grant of £5.95 million in May 1995 towards project costs of £11.93 million. Following this, further design work on educational facilities, display areas and disabled access arrangements (which were important to the aims and operation of the Centre) increased the cost of the project. The detailed plans called for a high proportion of glass to be used in the Centre's roof. This was important to the architectural concept of the building but was expensive; a one per cent increase in the amount of glass added £30,000 to the cost. Together, these changes raised the total cost by £1.27 million. The grant recipient applied for and received a further grant of £950,000 in July 1996.

Case study 16 Cambridge Arts Theatre

The Arts Council initially awarded a grant of £6.64 million in May 1995, £5.74 million of which was to go towards the refurbishment of the Arts Theatre. By March 1996, the work programme was 15 weeks behind schedule, which threatened the re-opening of the theatre in December 1996. The project had also incurred extra costs. The Arts Council's supplementary grant of £750,000 covered the cost of an acceleration programme (to ensure completion on the scheduled date of 11 November 1996), contract variations, and additional professional fees and allowed a contingency to be included in the revised project budget. However, the project was not completed on the due date and staff had to move back into the Theatre while building work was still being carried out to ensure that the first production went ahead as planned.

3.17 Figure 16 shows that the supplementary grants made by the Arts Council for the eight projects in question totalled £13 million, and ranged from 0.6 per cent to 20 per cent of the amount originally granted to each of the projects. Although receipts from the lottery were initially higher than anticipated, in October 1997 the Arts Council's share of lottery funds was reduced to make provision for the sixth good cause. The Arts Council are also committed to funding their other lottery programmes (paragraph 1.7). Consequently, the amount of funds that will be available for the capital programme in future has fallen sharply and the Arts Council now have a limited pool of money ear-marked for supplementary grants. This underlines the need for the Arts Council to ensure that project costs are properly established prior to the main construction work commencing.

3.18 Several of the projects we examined had been awarded grants before design and development work had been completed and therefore before the likely cost of the project was fully understood. In some of these cases, the grant was awarded subject to completion of the detailed work on design, development and costing. Since making the lottery awards for the 15 projects we examined, the Arts Council have introduced, in July 1997, new three-stage application and assessment procedures for major capital projects (with a total cost of £500,000 or

more). Under these new arrangements, the Arts Council do not offer a grant for the construction stage of a project until they are satisfied that all design and development work has been satisfactorily completed and that the cost of the project has become fixed.

The need for timely and decisive action

3.19 The Arts Council recognise the need to intervene where monitoring reveals significant problems with a project or its financing that are not being adequately addressed by the grant recipient. Failure to do so would put the investment of lottery funds at risk, and it is important in these circumstances that the Arts Council take timely and decisive action to keep the risks under control. The Arts Council consider that they usually get just one opportunity to place a project on hold, early on in its lifetime, and that once funding commences and the project progresses, the cost and other penalties of putting the project on hold - or of aborting it altogether - might increase substantially. Similarly, by continuing to fund the project, the Arts Council might be reducing the options open to them in the future as a greater amount of lottery funds will by then have been paid out.

3.20 In these circumstances, the Arts Council need to ensure that the special conditions attached to offers of grant are met or that alternative ways are found for controlling the risks that the special conditions were intended to cover. The Arts Council also need to ensure that, in deciding how to respond, they consider fully the various options open to them. In particular, where a major decision point is reached on a project, and it is clear that there is a significantly increased risk to lottery funds in proceeding, it is important that all the available options are considered formally and a decision made at an appropriate level (either by the Council itself or by senior officials). The Lottery Advisory Panel should be kept fully informed at all stages and consulted for advice wherever practicable.

(i) Enforcing special conditions

3.21 The Arts Council attach special conditions to their offers of lottery grant where there are specific risks that need to be addressed, either before the project gets underway or before it reaches a particular milestone. These risks are not sufficient to outweigh the merits of the project, but they need to be addressed to the Arts Council's satisfaction if the project in question is not to be undermined. Each of the 15 projects we examined had to comply with a range of special conditions. Many related to artistic or operational matters not covered in this report. But on

13 of the 15 projects examined, the Arts Council attached special conditions to address specific financial or project management risks. Examples of the special conditions for the projects we examined are set out in Figure 17.

Examples of special conditions attached to the projects examined to cover financial and project management risks

Figure 17

Prior to any grant payment, a revised capital project budget should be submitted to the Arts Council for assessment (Dovecot Arts Centre)

The grant recipient is to provide the Arts Council with a marketing plan (Malvern Festival Theatre)

The final £950,000 of the grant, towards the fitting out of the Inigo Jones Theatre, will be not be available until the Arts Council are satisfied with the trading performance and future projections of the company and that the fitting out of the basement exhibition has been completed (Shakespeare Globe)

The Arts Council require evidence that provision will be made, within the revenue budget, to ensure proper long-term maintenance, repair and replacement of items purchased with lottery monies (Royal National Theatre)

Prior to any grant being provided, the grant recipient is to provide evidence that partnership funding has been raised towards this project (Royal Exchange Theatre)

Source: National Audit Office analysis of Arts Council offers of lottery grant

3.22 In most cases, the grant recipient satisfied the special conditions attached to the offer of grant. However, on three projects we found that the special conditions had not been met or that the Arts Council had deferred the deadline for fulfilment. Details of these cases are set out in Figure 18. In each case, the special conditions were clearly designed to cover serious risks concerning project planning, financing and management and control. For two projects, the Royal Court Theatre and the Royal Opera House, the risks were particularly high.

3.23 In the case of the Royal Court Theatre, the Arts Council imposed the special conditions because they were concerned about the level of uncertainty over the overall cost and financing of the project. The crucial condition required the Arts Council to be satisfied with the financing of the project prior to paying out lottery grant in excess of £2.5 million. The Arts Council informed the Royal Court Theatre in October 1996, when they had paid out £2.48 million, that they were satisfied that this condition had been met. However, there were still concerns surrounding a significant amount of the project's partnership funding and the reliability of the Theatre's cashflow projections, which meant that the risks associated with the financing of this project remained high (case study 17). The Arts Council were concerned that progress on the project should not be delayed, but recognised the risks involved and continued to monitor the position closely.

Figure 18

Examples of projects where special conditions have not been fully fulfilled

This shows how the Arts Council have responded where changes in circumstances on individual projects have caused difficulties in fulfilling special conditions

Project	Special Condition	Risk covered	Outcome
Royal Academy of Dramatic Art, London	The Academy was required to demonstrate by the end of January 1997 that there was in place a defined scope of works, a total project cost, and a master programme which took proper account of delivering the project within available finances.	This is a complex multi-phase project spread over many years, so certain aspects of it could not be fully developed at the time the Academy applied for a grant. Consequently, a special condition required a major review of project progress in September 1996. This review identified a number of outstanding issues and so the special condition was revised to focus on these.	The Arts Council consider that it became impractical to stick to the original deadline for fulfilling the condition because elements of the project were still being developed. The Academy is still required to comply with the substance of this condition, but it will not be able to fulfil it until it has re-examined the scope of the project and the result of all their tendering is known. This will not be until April 1999.
	The Academy was required to provide proof that at least 25 per cent of partnership funding had been raised towards the project prior to any grant payment being made.	When the Academy applied for a grant, it needed to raise £8 million of partnership funding by 2000. The Academy advised the Arts Council that up to £2 million should be in place by the end of May 1996. The level of fundraising was seen as critical to the success of the project and so the special condition was set to ensure that the Academy met its first target.	This special condition was not met in its original terms. Following a review in September 1996, the Arts Council accepted that achieving the required £8 million partnership funding in equal amounts over a period of over four years from the date of the award was an acceptable alternative.
Royal Court Theatre, London	The Theatre was to provide a cashflow forecast showing the timing of the first £1.2 million of grant prior to such payments being made.	The Arts Council were concerned about the cost of the project, the lack of development of certain aspects, and the financing of the project. In order to keep the pace of development under control, various special conditions with financial limits were imposed.	More than £1.2 million was paid before the terms of this condition were fulfilled, though negotiations were taking place about the acceptability of data on cashflows provided by the Theatre.
	Prior to any grant in excess of £2.5 million being provided, the Arts Council were to be satisfied with further revised financial forecasts, costings, a cashflow forecast and timetable for the project to completion.		On 30 October 1996, when a total of £2.48 million grant had been paid, the Arts Council accepted revised cashflow forecasts and stated that they were satisfied that the condition had been fulfilled. However, significant risks remained (case study 17).

continued ...

Figure 18**Examples of projects where special conditions have not been fully fulfilled (*continued*)**

Project	Special Condition	Risk covered	Outcome
Royal Opera House, London	<p>The Royal Opera House was required to submit a revised business plan demonstrating the financial viability of the organisation during closure and after re-opening.</p> <p>A further condition required the Royal Opera House to produce finalised plans for the closure period which satisfied the Arts Council.</p>	<p>The scale and complexity of this project created substantial risks, some of which were exacerbated by a lack of detailed planning when the lottery grant was applied for. Concerns centred on budgetary and cashflow planning for the closure period and the management structure and financial viability of the Royal Opera House on re-opening.</p>	<p>The first of these special conditions has not been met - as at 31 October 1998, a revised business plan had not been submitted.</p> <p>A plan and budget for the closure period was submitted and, subject to certain reservations, was accepted by the Arts Council in March 1997. However, this plan was overtaken by subsequent developments at the Royal Opera House. A revised final budget for 1998-99, and draft projections for the following two years (including the first full year after re-opening), were not provided until June 1998. By that stage £65 million of the total £78.5 million lottery grant had been paid.</p>

Source: National Audit Office analysis

Case study 17 Royal Court Theatre, London

As part of the original award to the Royal Court Theatre, the Arts Council imposed a special condition that, prior to grant payments in excess of £2.5 million, the Arts Council should be satisfied with:

- revised financial forecasts for the period in which the Theatre would be closed and the first three years after re-opening; and
- revised detailed costings and a cashflow forecast for the project showing the anticipated timing of grant payments.

This special condition was intended to ensure that once project costs were established and operating forecasts taken into account, the Theatre could show that there was sufficient funding in place to complete the project.

continued ...

In September 1996, the Royal Court Theatre provided the Arts Council with project cost schedules. The Arts Council compared the fundraising and lottery grant implications of these schedules with the actual fundraising plans and identified significant shortfalls. They were also concerned about some of the assumptions underlying the projections. Throughout October 1996, the Arts Council continued to liaise closely with the Theatre's Finance Director to ensure that the Theatre prepared revised cashflow schedules, based on various different scenarios concerning the timing of partnership funding, payment ratios and the Theatre's own reserves. By this time, the Arts Council had paid out £2.48 million. Towards the end of October 1996, the Theatre produced a cashflow schedule that the Arts Council accepted as satisfying the special condition in question, in that it showed a positive cashflow throughout the project. However, the schedule assumed that:

- the major partnership funding donation of £3 million would begin to be received in January 1998;
- the Theatre would use £325,000 of its reserves as partnership funding; and
- the Arts Council would amend the ratio of lottery grant payments on capital and closure costs to 80 per cent grant and 20 per cent partnership funding (on a cumulative basis) throughout the life of the project.

As at 31 October 1998, the £3 million partnership funding donation had still not been received and the Arts Council were paying 100 per cent of the costs, though the Theatre were proposing to make a 25 per cent contribution to project costs from November 1998 onwards.

3.24 In the case of the Royal Opera House, the scale and complexity of the project, together with the need for further detailed planning in respect of the closure period, led the Arts Council to impose a key special condition. This required the Royal Opera House to produce a revised business plan that demonstrated the financial viability of the organisation during closure and after re-opening. As at 31 October 1998, such a plan had not been produced and revised budgets and draft projections produced in June 1998 showed the Royal Opera House's cumulative financial operating deficit increasing from £5.14 million in 1998-99 to £14.36 million in 2000-01 (case study 18). By the end of October 1998, the Arts Council had paid out £68 million of the £78.5 million lottery grant. The Arts Council were satisfied with the progress of the construction project and considered that the consequences of withholding lottery funds would be potentially very damaging.

Case study 18 Royal Opera House, London

A key special condition of the July 1995 lottery grant to the Royal Opera House was the submission of a revised business plan, demonstrating its financial viability during closure and after re-opening. In June 1997, the Arts Council noted that a balanced budget had only been provided for the first year of closure (1997-98). The Arts Council stated that they wished to receive satisfactory budgets for the second and third years of closure no later than 1 October 1997 and, for the first year after re-opening, no later than 1 April 1998.

Also in March 1997, the Royal Opera House realised that it faced serious financial difficulties and projected a deficit for 1997-98 of £1.5 million. The Arts Council were in close and regular contact with the Royal Opera House during this time. By the end of June 1997, the Arts Council had paid almost £18.4 million of the lottery grant on the basis that the construction project was proceeding satisfactorily.

The Royal Opera House told the Arts Council in October 1997 that budgets for the second and third years of closure were not ready and that draft budgets forecast a significant deficit. By the deadline of 1 October 1997, the Arts Council had paid over £32 million of the lottery grant.

In December 1997, the Arts Council confirmed that the Royal Opera House should produce plans for the re-opening of the Royal Opera House by 1 April 1998 and that the receipt of those plans would be a condition for drawdown of subsequent lottery money. At the end of February 1998, the Royal Opera House admitted that its management and financial information system had broken down catastrophically. Consequently, it was unable to produce either a balanced budget for 1998-99 or a revised business plan by 1 April 1998. Nor could it provide the Arts Council with sufficient management information to enable the Arts Council to verify independently the state of solvency of the Royal Opera House. The Royal Opera House promised both a full budget for 1998-99 and the business plan by 1 July 1998. By early March 1998, the Arts Council had paid over £52 million of the lottery grant.

At the beginning of May 1998, the Chief Executive of the Royal Opera House informed the Arts Council that the business plan, promised for 1 July 1998, would not be finalised by then. This was principally because of a potentially large funding gap between the anticipated costs in the new building and likely income from box office, donations, commercial revenue and Arts Council subsidy. The Arts Council expressed their concern that a funding gap, then estimated to be up to £15 million, should be emerging. It was precisely because of the potential increase in the costs of operating the new building that the Arts Council had been anxious to receive a business plan.

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The Arts Council received the final budget for 1998-99 and draft projections for 1999-2000 and 2000-01 on 24 June 1998. The 1998-99 budget forecast a deficit of £5.14 million. Projections for 1999-2000 and 2000-01 show annual deficits of £13.99 million and £14.36 million respectively. By the end of October 1998, the Arts Council had paid out £68 million of the £78.5 million lottery grant.

Continuing financial difficulties have resulted in the Royal Opera House proposing a radical restructuring plan, including reduced levels of performance during the closure period and on re-opening. As at 31 October 1998, these proposals were still under discussion.

3.25 In each of these cases, the Arts Council came under pressure from the grant recipient to continue funding the project even though the special conditions had not been fulfilled in accordance with their original terms. We recognise that a decision whether or not to vary or defer the original terms for fulfilment of a special condition is essentially a matter of judgement, having regard to all the facts and circumstances in each particular case. In two cases, some of the risks that the special conditions were intended to cover still existed and we consider that the Arts Council would have been justified in seeking to take a tougher line than they did in enforcing the special conditions as a means of putting the project on a sounder footing. However, we recognise that the Arts Council considered the risks in question and weighed these against all the other relevant factors before reaching a decision. In these two cases, the Arts Council judged that adhering to the terms in which the special conditions were originally expressed was not feasible and might have jeopardised further progress on the projects.

(ii) Taking action at major decision points

3.26 Where a major decision point is reached on a project, the Arts Council need to consider all the options open to them, including suspending grant payments and recommending that the project be put 'on hold'. This would provide an opportunity for all the parties involved to focus on the problems and work out a satisfactory way forward. Although halting progress on a project, for whatever reason, causes delay and will therefore increase the total cost, it also provides a strong focus for resolving the problems, which might result in the project emerging in a stronger position. If it is clear to the Arts Council that allowing a project to proceed would result in significantly increased risk to lottery funds, it is important that senior officers and, where necessary, the Council itself are given a formal opportunity to decide on the appropriate action. The Lottery Advisory Panel should also be kept fully informed at all stages and consulted for advice wherever practicable. Comprehensive information should be provided on the options that are available and each course of action should be clearly spelt out with the costs, benefits and

implications for the future operation of the project identified fully. Where halting progress on the project is one option, the analysis should assess what impact this might have on the future of the project or on the viability of the grant recipient.

3.27 For three projects, the assistance provided by the Arts Council – including relaxing the timing of partnership funding requirements and associated grant payment arrangements (paragraphs 3.9 to 3.13) and making supplementary grants (paragraphs 3.14 to 3.18) – was not enough to resolve the financial difficulties they were facing. In each case, we found that the Arts Council’s main concern was to try and find ways of keeping the project going, whilst ensuring that the risks were kept to an acceptable level and that the problems being experienced, which were central to the financial viability and management of the project, were resolved satisfactorily.

3.28 The project to redevelop and refurbish the Royal Academy of Dramatic Art has been beset with financial difficulties. The estimated total project cost increased from £30.76 million in May 1996 to £32.43 million at October 1998 (an increase of £1.67 million or 5.4 per cent), though attempts are still being made to bring the cost back within budget. In addition, the Academy has struggled to raise the required partnership funding. The difficulties experienced by the Academy and the action taken by the Arts Council to assist the project and control the risks involved are set out in case study 19.

Case study 19 The Royal Academy of Dramatic Art, London

In April 1997, the Academy’s annual report raised serious concerns about cost overruns, delays, relocation and partnership funding. The Arts Council warned the Academy that the feasibility of the project would have to be considered and that no demolition work should proceed until they were satisfied that partnership funding targets would be met and relocation satisfactorily achieved. Assurances on both these issues were provided by the Academy later in April 1997 and the Arts Council gave approval for the development to proceed.

The Arts Council have helped the Academy to overcome cashflow problems wherever possible. In June 1997, the Arts Council agreed to postpone their first charge on two properties until April 1998, later extended to August 1998, to enable the Academy to use the properties as collateral for a loan of up to £1 million. Also in June 1997, the Arts Council agreed to pay 100 per cent of the building project costs until further notice.

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By May 1998, the forecast project cost had increased significantly, largely due to overspends on the main building elements of the project, the projected cost of the media facilities (not part of the original scheme), an increase in relocation costs, and an increase in the Academy's accumulated operating deficit. Some elements of the project are experiencing delays of up to 12 months. The Academy's partnership funding is now considerably higher than the original £8 million and the financial and partnership funding monitor reported concern that the Academy did not appear to be addressing the need to raise the additional amounts now required.

The Arts Council told the Academy in June 1998 that they expected a series of radical proposals to be developed to address the problems. They would not approve the next phase of the Gower and Malet Street redevelopment until they considered that the project was on line to succeed. In July 1998, the Academy produced a fundraising strategy aimed at satisfying the Arts Council's concerns. The strategy centred on the Arts Council continuing to pay 100 per cent of the building project costs until April 1999, when the Academy would begin to contribute 20 per cent from partnership funds. Once the Arts Council's grant was expended, the Academy would meet the full costs of the development. On this basis, the Arts Council gave approval for the development to continue and agreed to certain reductions in the scope of the project. As at October 1998, the forecast project cost was £32.43 million, leaving a partnership funding requirement of £9.68 million (an increase of 21 per cent).

3.29 The Arts Council considered this project to be high risk at the outset and kept it under continuous close scrutiny. They appointed separate monitors to cover the building works and financial and partnership funding aspects. These monitors kept them informed of the increasing project costs and deteriorating financial position. The Arts Council consider that they took decisive action in April 1997 to keep the project under control in the light of concerns about cost overruns and delays. However, despite the assurances given by the Academy and accepted by the Arts Council in respect of these concerns and also the level of partnership funding, the Arts Council had to insist in June 1998 that the Academy develop more radical proposals to address the problems. The Arts Council kept their Lottery Advisory Panel informed throughout 1997 and 1998 of progress on this project, but neither the Arts Council nor the specialist monitors and advisers or the Panel itself considered that the risks were sufficiently serious to merit a formal re-consideration by the Panel of their support for the project.

3.30 By October 1997, the cost of the project to rebuild Sadler's Wells Theatre had risen to £48 million, an increase of £9.65 million or 25 per cent (case study 13). This caused problems in raising the finance required within the timescale for completing the project. The theatre's application for a supplementary grant of £6 million in October 1997 was subject to a full assessment, as with all new applications. The paper submitted to the Lottery Advisory Panel in December 1997

highlighted concerns about partnership funding and viability and the potentially serious adverse consequences for lyric theatre in London if the project was not completed on time. The Arts Council scored the application very highly on assessment criteria relating to artistic activities and benefit to the public, but considered it to be just adequate in relation to long term financial stability and partnership funding. The Arts Council offered a supplementary grant of £6 million, bringing the total lottery grant up to £36 million. By 31 October 1998, the total project cost had increased by a further £4.5 million, leaving a total partnership funding requirement of £16.5 million. This represents an increase of 129 per cent over the £7.2 million partnership funding needed when the original award was made (case study 20).

Case study 20 **Sadler's Wells Theatre, London**

The amount of partnership funding required under Sadler's Wells Theatre's original application was £7.2 million and even then the Arts Council's assessor raised doubts about the Theatre's ability to reach this target within the tight development timescale. The Theatre applied for a supplementary grant of £6 million in October 1997. The paper submitted to the Lottery Advisory Panel in December 1997 reflected the external assessor's view that Sadler's Wells was financially particularly vulnerable if it failed to clear its historic deficit and meet its partnership funding requirement before the opening of the new building. It also reported that the Building Monitor had identified a maximum cash shortfall of over £1 million by December 1998. However, the paper also noted that contracts had been signed by Sadler's Wells with the Royal Opera House for the 1998 Royal Opera and Royal Ballet seasons and that if the Theatre was not finished on schedule, lyric theatre in London would be significantly jeopardised. The application for the supplementary grant was scored highly by the Arts Council on assessment criteria relating to the quality of artistic activities and benefit to the public, but was considered to be just adequate in respect of long term financial stability and partnership funding. The Panel were informed when they met that if the additional money was not forthcoming, the building work would stop. The Panel agreed to recommend further funding of up to £6 million, but asked that the figures be examined carefully in an attempt to reduce the amount needed. The Arts Council were not able to achieve this and a supplementary grant of £6 million was made in March 1998.

As at 31 October 1998, the total project cost stood at £52.5 million, leaving a partnership funding requirement of £16.5 million, an increase of 129 per cent in the three years since the award was made. However, as at 31 October 1998, three years after the lottery award was made, only £5.95 million had been raised. Although the main Theatre re-opened in October 1998, work on other elements of the project will be carried out as and when funds become available. In January 1999, the grant recipient arranged a loan of £3 million secured on the Theatre. The project as a whole is not now expected to be completed until at least 2001.

3.31 Cost increases and difficulties in raising partnership funding have also been a feature of the project to re-build the Royal Court Theatre. This has escalated the financial difficulties faced by the project (case study 21).

Case study 21 **Royal Court Theatre, London**

The original partnership funding requirement was £5.27 million and £3 million of this was expected to come from a single donor, the freehold owner of the Theatre. However, the prospective donor was concerned to secure a return on their investment and it was proposed that this would take the form of a 'planning gain' (a potential financial gain resulting from planning approval) on another property. In February 1996, the prospective donor warned the grant recipient that a delay and a reduction in the amount of the donation were likely. Over the next six months, both the Arts Council's Building Monitor and the Lottery Operations Officer expressed concern about the amount and timing of this donation. In March 1997, the prospective donor's planning application was rejected, though they reaffirmed their commitment to the development plans.

In September 1996, the Operations Officer analysed the project cost forecasts and fundraising plans provided by the grant recipient and identified a deficit each month from April 1997 to June 1998, ranging in size from £78,000 to £1.19 million. The officer concluded that the project (as then approved) should not proceed and that consideration should be given to referring the project back to the Council for their agreement to proceed on the basis that further lottery funding might be needed. However, having reviewed the situation carefully, the Arts Council's senior management decided that the project, as funded, should proceed, subject to the grant recipient providing satisfactory financial projections for the project (case study 17). When responsibility for the project passed to the Projects Unit in October 1996, the Projects Officer carried out a further detailed review and the financial position remained under close scrutiny for the next 12 months.

When the Arts Council were informed about delays to the construction programme in August 1997, they carried out a further review of the project. This was undertaken with the assistance of external financial advisers and other specialists. In October 1997, the Arts Council commissioned external consultants (Pannell, Kerr, Forster) to assist the grant recipient in drawing up further operational and financial plans in the light of this delay. They concluded that there was still a significant risk that the inflow of partnership funding would occur too slowly and jeopardise the completion of the project. However, the Arts Council accepted the grant recipient's assurances about their fundraising campaign, which were still centred on the prospective donor.

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Over the next six months, the project cashflow problems intensified. The grant recipient had requested and received a special payment of £80,000 to help meet its monthly VAT payments in October 1997. In addition, the Arts Council, which had already been funding the project at 80 per cent since November 1996, agreed to fund the project at 100 per cent from November 1997 to April 1998 and in May 1998 this was extended indefinitely.

Following the grant recipient's application for a supplementary grant of £1.87 million in November 1997, the Arts Council's external assessor, in February 1998, set out three possible courses of action:

- abort the project and allow the grant recipient to go into liquidation;
- truncate or partially complete the building project in order to absorb the increased costs within the capital budget; or
- increase funding by £1.87 million as per the application.

The paper submitted to the Lottery Advisory Panel in March 1998 set out the problems that have affected the project and identified the cashflow difficulties arising from the gap in partnership funding. The options put forward by the external assessor, and the implications of each, were set out in the background notes attached to the paper. The paper recommended that a further £1.64 million be awarded, for construction costs only, to resolve the project's difficulties and that the Arts Council should continue temporarily funding the project at 100 per cent pending resolution of the partnership funding situation. The partnership funding criterion was scored as '6' (on a scale of 1 to 10) which the Arts Council have defined as 'fundraising partly achieved and strategy proving effective'. However, the Panel had no confidence that the partnership funding could be raised or the costs maintained and they requested that the criterion be re-scored.

Subsequent papers submitted to the Panel in April and July 1998 included a full financial appraisal of each of the options open to the Arts Council, including aborting the project, and a more realistic assessment of the partnership funding situation. The Panel was also informed that termination of the project would cost approximately £2 million (excluding liquidation costs) and would result in expenditure of over £10 million of lottery funds with no arts or public benefit delivered.

In May 1998, the prospective donor informed the grant recipient that they were not in a position to provide any funds, except for a 'gift aid' donation of £250,000, which they paid over in June 1998. They are holding out the possibility of a further £1 million, but the terms for accepting this are not acceptable to the grant recipient. In the meantime, a new donor has stepped in to enable the project to be completed. In July 1998, the Panel recommended a further lottery grant of up to £2,545,345, conditional upon the partnership funding situation being resolved.

3.32 The paper submitted to the Lottery Advisory Panel in March 1998 recognised that this particular £3 million donation was becoming increasingly tenuous, and invited the Panel to endorse one of two fallback options identified in the paper in the event that the donation did not materialise. However, the paper did not identify the possible need for a different strategy altogether on partnership funding. The paper referred to the three options identified by the Arts Council's external assessor, including aborting the project, but it did not invite the Panel to form a view on the Arts Council's preferred option (to increase funding for the capital project). Following the concerns expressed by the Panel at their meeting in March 1998, subsequent papers presented to the Panel drew more explicit attention to these three options and included more information on the grant recipient's performance in raising partnership funding, along with more detailed analysis of the financial risks to the Arts Council.

3.33 The Arts Council stressed that although they were fully aware of the difficulties being experienced by this project, and of the risks involved, they nevertheless judged it appropriate to allow the project to proceed, and expenditure commitments to be entered into, while attempts were being made to resolve those difficulties. In making this decision, they had regard to the cost of halting work and the substantial benefits that this major project was designed to deliver. The required partnership funding for this project has now been secured from a different source and the project is on course to be completed in June 1999.

3.34 For each of these three projects (the Royal Academy of Dramatic Art, Sadler's Wells Theatre and the Royal Court Theatre), the Arts Council had to strike a balance between allowing the project to continue, while keeping the risks to an acceptable level, and halting work altogether (with the risks and costs that would entail) until satisfactory proposals had been agreed for financing the project through to completion. In each case, the Arts Council judged that the right course was to allow work to continue, while at the same time seeking to ensure that the risks were contained and that the funding and other difficulties were resolved satisfactorily. However, although the Arts Council informed the Lottery Advisory Panel, through written and oral briefings, of the financial risks involved and the different options available, we consider that they could, on occasions, have set out the options more formally than they did, together with an explicit invitation to the Panel to consider them. They now ensure that this is done.

Ensuring the long-term financial viability of projects

3.35 The Financial Directions issued to the Arts Council by the Department for Culture, Media and Sport require the Arts Council to safeguard the use of lottery funds and ensure that projects deliver the benefits set out in the application. It is therefore important that the grant recipient is in good financial health and capable of running the lottery-funded facility following its completion. If this is not the case, the facility might have to close and there will be no return on the Arts Council's investment of lottery funds. Only one of the 15 projects we examined was complete when we carried out our examination: the Cambridge Arts Theatre. The Theatre experienced financial difficulties soon after re-opening and the Arts Council had to work closely with the grant recipient to secure the future of the Theatre (case study 22).

Case study 22 Cambridge Arts Theatre

This £12.14 million project consisted of three elements: refurbishment of the Arts Theatre, renovation and repair of the Festival Theatre, and a feasibility study to consider rebuilding the Arts Cinema. The financial position of the grant recipient was weak but this was not sufficiently identified during the assessment process. The Arts Council awarded a grant of £6.64 million in May 1995 and made a supplementary grant of up to £750,000 in November 1996 to help cover rising costs. The amount of partnership funding required rose from £5.11 million to £5.64 million. By the time the theatre re-opened in December 1996, the grant recipient was in serious financial difficulties. Disappointing box office results and less than expected catering income exacerbated the problem.

In June 1997, the grant recipient applied to the Arts Council for contingency funding to help save them from insolvency. The Arts Council commissioned an independent consultant to conduct a review of the financial position. The consultant concluded that the financial crisis was such that the Arts Council should not fund any more work unless the grant recipient was already contractually committed or could show short-term financial benefit.

By December 1997 the position had deteriorated further. The Arts Council's consultant considered that the grant recipient would cease trading and have to sell its assets to discharge its debts if the Arts Council did not provide additional funding. If the Arts Theatre was sold, it was likely that it would realise a sum substantially less than the lottery grant that contributed to its refurbishment.

The Arts Council agreed to pay £574,000 of the unclaimed balance of the grant (mainly relating to the Festival Theatre element) to help secure the Arts Theatre's survival. The grant recipient's creditors also agreed to accept payment at 25 pence in the pound. New management has been brought in to help overcome the problems. To ensure the Arts Theatre's survival, the Festival Theatre was sold in March 1998 and the Arts Cinema will be sold in the near future.

3.36 One of the criteria by which the Arts Council assess all lottery applications is the extent to which the project will assist the applicant in achieving longer term financial stability. This is particularly important for organisations like the Royal Academy of Dramatic Art and the Royal Opera House, both of which had accumulated financial deficits that their respective lottery projects were, at least in part, designed to address. However, the Arts Council's project monitoring revealed that both organisations were experiencing worsening deficits. It is therefore possible that the financial benefits envisaged for the projects will no longer be sufficient to secure the longer term viability of the organisations concerned.

3.37 The project to redevelop the Royal Academy of Dramatic Art incorporated proposals for putting the Academy onto a sound financial footing by financial year 2000-01. However, as at 31 October 1998, progress against these proposals has been limited (case study 23).

Case study 23 The Royal Academy of Dramatic Art, London

When the Academy submitted its lottery application it was already experiencing financial difficulties. The Academy had been running substantial deficits since 1990 and had an overdraft of almost £1 million. The Academy's aim was to break even by financial year 2000-2001 and generate surpluses beyond this period. One of the ways it proposed to do this was by raising £6 million of the £8 million partnership funding requirement for non-construction purposes. Of this, £1.5 million was to pay off the accumulated overdraft and the projected decreasing annual deficits. The remaining £4.5 million would be used to set up a trust fund to provide an income stream of £315,000 per year by 2000.

The Arts Council's assessor expressed concern about the adequacy of the trust fund. The paper submitted to the Lottery Advisory Panel in April 1996 gave the project the lowest score for long term financial stability that was compatible with a project being awarded a lottery grant. The Academy was awarded a grant of £22.75 million in May 1996.

In May 1998, the Arts Council's specialist monitor for financial and partnership funding matters concluded that the Academy's operational deficit was unsustainable in the medium to long term without radical action to reduce deficits. The deficit for 1997-98 alone was £648,000. The Academy now expect actual and forecast annual deficits to total over £3 million by 2004. An additional £1.5 million will need to be raised to fund these deficits. The Arts Council's specialist monitor expects the future deficits to be even higher than the latest projections. To date, the Academy has made no contributions to the creation of the trust fund. No trust fund income is shown in the forecast financial projections and the Academy does not intend to commence fundraising for this until the development is completed (expected to be in 2001).

3.38 In June 1998, the Arts Council informed the Royal Academy of Dramatic Art that they expected them to develop radical proposals to address the Academy's financial difficulties. The Arts Council wished to consider these proposals before they approved the next phase of the redevelopment. The Academy submitted a fundraising strategy in July 1998 which shows their operating deficit continuing at an average level of £400,000 per year and only gradually diminishing once the trust fund is established. Fundraising for this is not now expected to commence until 2002. The redevelopment project will clearly not assist the Academy in the short term in achieving financial stability, and it might even add to the Academy's running costs.

3.39 The assessment of the Royal Opera House's 1995 lottery application considered that the project should improve the financial stability of the Royal Opera House. This would be achieved through improved productivity, enhanced income potential and the generation of an endowment fund to provide a new source of secure income. The endowment fund is dependent upon the success of the public appeal for funding the project. However, since the project commenced, the Royal Opera House has faced several financial crises and a growing deficit between income and expenditure. As at 31 October 1998, it saw little prospect of reducing the deficit, given its level of funding at that time, and its financial viability when it occupies its new home at the end of 1999 was being called into question (case study 24).

Case study 24 Royal Opera House, London

In January 1995, the Royal Opera House's lottery application included a simple business plan for the period 1996-97 to 2000-01 that showed a balanced budget for 1996-97 (the last full year in the old theatre) and 2000-01 (the first full year in the new theatre) based on expected subsidy and donations. The Arts Council's assessment considered that the redevelopment would improve the financial stability of the Royal Opera House by improving its productivity and through the ability to earn more from enhanced audience facilities. If an endowment fund was established, this would provide a new source of secure income.

The Royal Opera House published annual accounts for 1994-95 in July 1995 that showed an accumulated deficit of £683,000. Towards the end of July 1995, the Arts Council approved the first tranche of grant of £55 million for redevelopment. By the end of 1995-96 the accumulated deficit stood at £3.2 million. The second tranche of grant of £23.5 million was approved in March 1997.

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By June 1997 the financial position had deteriorated significantly, with an accumulated deficit at the end of 1996-97 of £4.7 million and projected annual operating deficits of between £1 and £1.5 million for the next three years. Following completion of the project, the new Royal Opera House was likely to incur an annual deficit of at least £2 million. The Royal Opera House also anticipated a £3.5 million shortfall of funding against closure costs. The Royal Opera House only remained solvent due to a loan from private sources of £2 million in July 1997.

By October 1997 the Royal Opera House was again on the brink of insolvency, having discovered that its operational plans for the next two years would lead to a deficit of £11.2 million in addition to the £5 million deficit that had accrued at the point of closure. A £10 million 'rescue package' was announced in November 1997 which sought to provide financial security through the remainder of the closure period.

The 1997-98 accounts showed a deficit for the year of £3 million and an accumulated deficit of £7.7 million. The budget for 1998-99 now forecast a deficit of £5.1 million, giving a potential accumulated deficit at the end of 1998-99 of £12.8 million. At the same time, the Royal Opera House told the Arts Council that, although sound figures for 1999-2000 were unavailable, the year as then planned would give rise to a substantial deficit. If grant-in-aid from the Arts Council remained at 1998-99 levels, the likely deficit was in the range £10-15 million, giving an accumulated deficit of £22.8-27.8 million. The Royal Opera House saw no prospect of financing a deficit of this scale from donations or borrowing and needed additional revenue funding of at least £10 million a year. In June 1998, the Royal Opera House submitted financial forecasts to the Arts Council that showed a deficit for 2000-01 of £14.36 million. The future financial viability of the Royal Opera House is still uncertain. As at 31 October 1998, a radical plan for restructuring the organisation, including reduced staff numbers and more flexible working practices, was still under discussion.

3.40 We looked to see how the Royal Opera House's latest financial forecast for 2000-01 compared with that submitted with the original lottery application in 1995. The original business plan showed a balanced budget for 2000-01 with income (including donations and Arts Council grant-in-aid) of £54.1 million matching expenditure of £54.1 million. The forecast as at 31 October 1998 showed income of £47.68 million and expenditure at £62.04 million. Earned income was much as originally planned, but donations were down £4.2 million and the Arts Council's grant-in-aid was expected to remain at 1998-99 levels (£2.5 million less than originally budgeted). Expenditure was forecast to be £7.9 million higher than originally budgeted (although this provided for contingencies of £3 million compared with only £600,000 allowed in 1995).

3.41 The Royal Opera House has been under close scrutiny in the last twelve months. Reviews have been carried out on behalf of the Arts Council (the Walker-Arnott Report) and the Department for Culture, Media and Sport (the Eyre

Report). The Culture, Media and Sport Select Committee of the House of Commons has also published two reports on the Royal Opera House. As at 31 October 1998, no permanent solution for the Royal Opera House's financial difficulties had been found. There is therefore a risk that the redevelopment of the Royal Opera House will be completed at a cost to the Arts Council of £78.5 million, but that the benefits set out in the application, notably an improved and more stable financial position, will not be achieved.

3.42 For each of these three projects, the Arts Council have had to work closely with the grant recipient to try to ensure that they are, or will be, able to operate the lottery-funded facility after re-opening. Although the Arts Council have helped to secure the survival, at least temporarily, of the Cambridge Arts Theatre, as at 31 October 1998, there were still concerns about the future of the Royal Academy of Dramatic Art and the Royal Opera House.

Key Findings

3.43 The Arts Council have a substantial investment in each of the 15 projects we examined and, while the management of the project rests with the grant recipient, they are concerned to ensure that the project is completed successfully. They must take timely and decisive action to ensure that problems and risks identified by their project monitoring are acted upon.

3.44 The Arts Council encourage grant recipients to contain cost overruns within the original project budget, either by reducing the scope of the project or by deferring particular aspects. They also look to grant recipients to raise additional partnership funding. Twelve of the 15 projects we examined had, at some point, been over budget and this approach had succeeded in dealing with the problem in two cases.

3.45 For six of the 15 projects we examined, the Arts Council appointed a 'trouble shooter' or specialist adviser to work with the grant recipient to help them to deal with problems being experienced in managing the project. These 'trouble-shooters' and special advisers provided valuable assistance to the grant recipient in resolving the difficulties and also provided assurance to the Arts Council.

3.46 The Arts Council have assisted four of the 15 projects we examined that were experiencing cash flow difficulties by temporarily relaxing their requirements on the timing of partnership funding and by advancing the associated payment of lottery grant. In two of these cases, it will be several years before the approved lottery grant to partnership funding ratio is restored and until that time the risk will remain that the grant recipients will not be able to make good the shortfall in partnership funding.

3.47 The Arts Council have made supplementary grants totalling £13 million to eight of the 15 projects. These supplementary grants ranged from 0.6 per cent to 20 per cent of the amount originally awarded. This reduces the amount of lottery funds available for other projects. However, the Arts Council were satisfied in each case that the work remaining to be carried out was essential to the success of the project and would add value.

3.48 The Arts Council attached special conditions to 13 of the 15 projects we examined to address specific financial or project management risks. In two cases, the Arts Council allowed the project to proceed even though some of the risks that the special conditions were intended to cover still existed. We consider that the Arts Council would have been justified in seeking to take a tougher line than they did in enforcing the special conditions as a means of putting the projects on a sounder footing. However, we recognise that the Arts Council considered the risks in question alongside other relevant factors before reaching a decision. In these two cases, they judged that adhering to the terms in which the special conditions were originally expressed was not feasible and might have jeopardised further progress on the projects.

3.49 For three of the projects we examined, the additional financial assistance provided by the Arts Council - relaxing the timing of partnership funding requirements and associated payment arrangements and making supplementary grants - was not enough to resolve the financial difficulties they were facing. In each case, the Arts Council allowed work to continue, while seeking to ensure that the risks were contained and that the funding and other difficulties were resolved satisfactorily.

3.50 Where a project has experienced serious difficulties, the Arts Council have informed the Lottery Advisory Panel, through written and oral briefings, of the financial risks involved and the different options available. However, we consider that they could, on occasions, have set out the options more formally than they did, together with an explicit invitation to the Panel to consider them. They now ensure that this is done.

3.51 The financial health of the grant recipient is a key factor in securing the future of lottery-funded projects. In one case, the grant recipient experienced serious financial difficulties soon after re-opening and the Arts Council had to work closely with them to secure the future of the project. A further two projects were partly designed to assist the grant recipient in achieving longer term financial stability although, as at 31 October 1998, in both cases the grant recipient's financial position was worse than envisaged at the time of the lottery award.

Appendix 1

The framework for distributing the proceeds of the National Lottery

1 The share of proceeds raised by Camelot, the private sector operator of the National Lottery, for the ‘good causes’ is paid into the National Lottery Distribution Fund. The Fund was established under section 21 of the National Lottery etc. Act 1993 and the Permanent Secretary of the Department for Culture, Media and Sport is the Fund’s Accounting Officer. The purpose of the Fund is to:

- receive monies generated by the National Lottery for good causes;
- allocate these to the distributing bodies; and
- invest the funds, until such time as they are drawn down by the bodies for payment to grant recipients and to meet expenses.

Monies not immediately required for distribution are invested by the National Debt Commissioners, in accordance with directions issued by HM Treasury under section 32 of the National Lottery etc. Act 1993.

2 Section 22 of the National Lottery etc. Act 1993, as amended by the National Lottery Act 1998, divides the National Lottery Distribution Fund between the six good causes: arts; sport; the heritage; charities; projects to mark the new millennium; and expenditure on or connected with health, education or the environment. Funds for these good causes are channelled through twelve distributing bodies as shown in Table 1 below. The National Endowment for Science, Technology and the Arts does not receive a share of the National Lottery Distribution Fund but has been endowed with £200 million from the Fund.

3 Each distributing body is responsible for the way they distribute lottery funds. They are independent from day to day Government control, but operate within a framework of Policy and Financial Directions laid down by the Secretary of State for Culture, Media and Sport (or the Secretaries of State for Scotland, Wales and Northern Ireland).

**Distributing Bodies and
their share of the National
Lottery Distribution Fund**

Table 1

Good Cause	Distributing Body	Share of the NLDF %	
Arts	Arts Council of England	13.88	16.66
	Scottish Arts Council	1.48	
	Arts Council for Wales	0.83	
	Arts Council of Northern Ireland	0.47	
Sport	Sport England	13.88	16.66
	Scottish Sports Council	1.48	
	Sports Council for Wales	0.83	
	Sports Council for Northern Ireland	0.47	
Heritage	National Heritage Memorial Fund	16.67	
Charities	National Lottery Charities Board	16.67	
Millennium	Millennium Commission	20.00	
Health, education or environment	New Opportunities Fund	13.34 ¹	

Note: 1. When the Millennium Commission is wound up, its share of the National Lottery Distribution Fund will go to the New Opportunities Fund making its share 33.34 per cent.

Appendix 2

Policy Directions issued to the Arts Council of England under Section 26 of The National Lottery etc. Act 1993

The following Policy Directions were issued by the Secretary of State for National Heritage in June 1994, in exercise of the powers conferred by section 26(1) of the National Lottery etc. Act 1993, to the Arts Council of England:

1 In these Directions:

- a) any reference to a section is a reference to a section of the National Lottery etc. Act 1993;
- b) “capital expenditure” has the meaning given to that expression in the Schedule to these Directions.

2 The Arts Council of England shall take into account the following matters in determining the persons to whom, the purposes for which and the conditions subject to which it distributes money under section 25(1):

- a) the need to ensure that it does not solicit particular applications;
- b) the need to ensure that it considers applications which relate to the complete range of activities which fall within section 22(3)(a) and in respect of which the Arts Council of England has power to distribute money;
- c) the need to ensure that money is distributed under section 26(1) for projects which promote the public good (including the widening of public access) or charitable purposes and which are not intended primarily for private gain;
- d) the need for money distributed under section 25(1) to be distributed for the purpose of capital expenditure on projects and only to be otherwise distributed for the purpose of endowments or in the form of revenue grants where:
 - (i) such costs are associated with a capital project in respect of which money has been or is proposed to be distributed under section 25(1); and
 - (ii) the project would not otherwise be completed because no other finance for such cost is available;

- e)** the viability of projects and in particular the need for resources to be available to meet any running and maintenance costs associated with each project for a reasonable period, having regard to the size and nature of the project;
- f)** the need for projects to be supported by a significant element of partnership funding, and/or contributions in kind, from other sources;
- g)** such information as it considers necessary to make decisions on each application, including independent expert advice where required;
- h)** the need not to distribute money under section 25 to a company falling within section 27(2)(a);
- i)** the needs of projects relating to film and the moving image; and
- j)** the needs of projects relating to crafts.

These Policy Directions were extant when the Arts Council approved lottery funding for the 15 projects in this Report.

The Secretary of State issued additional Directions to the Arts Council: in April 1996 to allow the Arts Council to introduce certain supplementary schemes involving revenue expenditure; and again in August 1996 to allow the Arts Council to introduce their stabilisation programme.

The Secretary of State issued revised Policy Directions to the Arts Council in June 1998.

Appendix 3

Independent reviews of the Arts Council's lottery capital programme and project monitoring arrangements

Review of the lottery capital programme - Adrian Ellis Associates, October 1996

1 The first lottery awards were made in May 1995 and by 1996 the Arts Council recognised that there was a need to tighten the assessment criteria for the capital programme. Consequently, in July 1996, they commissioned a major review of the programme. Adrian Ellis Associates were employed with terms of reference that included wide-ranging policy analysis, reviewing the assessment criteria and redrafting guidance on these criteria.

2 The consultants reported to the Arts Council in October 1996. They concluded that there were no grounds for, and strong arguments against, making any radical changes to the capital programme. However, they had been disappointed with the quality of applications in a number of areas and they considered that there was scope for offering assistance to both applicants and grant recipients. In addition, they reported that the Arts Council's lottery policy had evolved quickly through decisions on specific applications and that this increased the risk of discrepancies in the treatment of applicants. The report also included proposals for the introduction of a new three-stage application process to more clearly define the work needed at the feasibility and developmental stages of a project.

3 The report's recommendations were largely accepted and subsequently implemented by the Arts Council. The recommendations relevant to project monitoring, and the action taken by the Arts Council, are set out in Table 2 below.

**The Ellis Review –
recommendations and
Arts Council action**

Table 2

Recommendations

Arts Council action

Applicants and assessors should have better guidance regarding projects' financial viability, calculation of partnership funding and assessment of capacity to raise further funding.

Various new or revised guidance issued, for example:

- guidance on organisational capacity, financial viability and value for money issued in November 1997 and aimed at applicants;
- a revised Assessors' Manual in December 1997.

All applications should include an options appraisal.

Options appraisals are now a standard requirement.

The assessment of financial viability should be expanded to include assessment of an organisation's capacity to manage a project through to a successful completion.

The criterion for assessment now takes account of the grant recipient's financial viability and quality of management. A proven track record, project management plan, and post-completion business planning are now standard requirements.

Applications relating to organisations in financial difficulties should only be considered if they specifically address that difficulty.

Applicants in financial difficulties must demonstrate that lottery funding will place their organisation on a firmer financial footing.

For larger building projects, a three-stage application process (feasibility/design development/full award) should replace the current two phases (feasibility/full award).

A new three-stage application process was introduced in July 1997 for capital project applications with a total cost of £500,000 or more.

4 Under the new three-stage application process, applicants must now:

- provide a detailed feasibility study and options appraisal, together with a comprehensive business plan (for the duration of the project and following its completion) which demonstrates that the applicant has the financial stability required to complete the project and operate the facility as a going concern;
- demonstrate how they would accommodate the impact on their income stream, during the project and following completion, of any construction delays, project cost overruns or shortfalls in partnership funding; and
- demonstrate that they have the organisational capacity to direct the project through to successful completion and that they have the necessary specialist project management expertise in place.

5 A follow-up review, in July 1998, concluded that the Arts Council had made considerable progress in implementing these recommendations and that this had led to major improvements in the assessment process. More rigorous assessment had identified problems at a much earlier stage. In addition, the three-stage application approach had reduced the amount of lottery funding approved to the minimum amount needed at each project stage. This was particularly important at the feasibility stage where there is a high degree of uncertainty. The follow-up review concluded that these improvements had reduced the level of risk that the Arts Council are exposed to when making grants, particularly during the early developmental stages of projects.

6 The review noted that the Arts Council have commissioned consultants to develop guidelines and benchmarks for assessing financial viability and to develop a standard approach to measuring the impact of capital investment on the financial viability of an organisation. However, it concluded that while the greater emphasis now placed on financial viability has had a significant impact on the assessment process, there is still insufficient guidance for assessing capacity to raise partnership funding and when a project should have the entire partnership funding in place.

Review of the Arts Council's project monitoring arrangements - Annabel Jackson Associates, October 1998

7 In June 1998, the Arts Council commissioned Annabel Jackson Associates to review the procedures for monitoring the progress of major capital projects. The report, in October 1998, concluded that the Arts Council have adopted a dynamic, action-oriented approach to monitoring, directed at problem resolution and learning. The report identified two advantages of this approach in terms of the way project monitoring is carried out:

- value for money: while there is a view that approved projects should not be given additional money because the overall number of projects that can be supported is reduced, this ignores the fact that some of these projects would then fail. Small additional amounts have a high added benefit in bringing to completion projects which would otherwise collapse.
- risk management: the Arts Council aim to avoid problems, or identify them at the earliest possible moment, because they become more difficult to solve, more expensive, and more complex the longer they are left. The

Arts Council are therefore balancing the cost of supporting projects early in their implementation against the risk of having to support them later, when problems have escalated.

8 The report made three strategic recommendations. The Arts Council should:

- explicitly endorse the ‘pro-active’ approach to monitoring;
- streamline the procedure for approving supplementary grants; and
- establish a dedicated business development team with the skills to provide management support to projects.

9 The report also made several recommendations, accepted by the Arts Council, for improving the way in which their project monitoring is carried out. The Arts Council should:

- ensure greater co-ordination of their project monitoring with other support functions, particularly organisational development;
- appoint Building Monitors early in the lifetime of a project, before the construction team is selected;
- provide Building Monitors with information on partnership funding and the financial standing of the grant recipient;
- ensure that information on overruns is fed back rapidly;
- streamline the reporting arrangements for Building Monitors, with key points set out in a separate covering letter;
- provide additional guidance to Building Monitors on priorities;
- extend the work of ‘trouble-shooters’; and
- strength their Business Assessment and Planning function, with the focus on financial viability and management.

10 The report also included a survey of Building Monitors, covering 156 projects of all sizes, on the progress of projects, their quality, and sources of risk. On progress, the survey concluded that about one-third of the 156 projects were completed on time or were on schedule. Almost 55 per cent of the projects were within, or had been completed within, budget. About one-third of projects under-estimated some major element of cost. Building Monitors considered that cost overruns cannot be tackled by eliminating inessential elements of the design; only five per cent of projects were judged to have unnecessary items.

11 On quality, Building Monitors expressed the view that projects are of high quality, with less than one in 20 (and mainly the smaller projects) being judged as poor. On risks, Building Monitors considered that almost 45 per cent of projects are without risk to their success. These were projects that were already completed, or had gone well. The main risks to successful completion are time factors and funding difficulties.

12 The main improvements suggested by Building Monitors were:

- stronger project management, and that this should be in place earlier in projects;
- more active direction from the Arts Council throughout the project to ensure that grant conditions are met and construction completed; and
- better financial control, in particular closer attention at the outset to detailed costings to ensure that the project is viable and budgets are realistic.

Review of the performance of Building Monitors - Currie & Brown, September 1998

13 The Arts Council commissioned a review of the performance of their Building Monitors prior to re-appointing them for a further 12 months. The Arts Council were concerned to ensure that, prior to being re-appointed, Building Monitors were carrying out the tasks required of them and ensuring that lottery funds are being expended in accordance with the conditions of grant.

14 The methodology for the review was two-fold: review of reports submitted by Building Monitors; and interview with the Arts Council's Projects Officers. Detailed criteria were set for evaluating the performance of Building Monitors. These included quality and completeness of information, accuracy of financial

reporting, ability to synthesise project management reports, ability to warn and advise, and frequency of site visits. The Arts Council intend to use the results of the exercise, which are commercial in confidence, in selecting Building Monitors for future projects.

15 The review identified several ways in which project monitoring could be improved:

- the payment of Building Monitors' fees should be conditional upon the timely receipt of reports;
- the standard Building Monitor report should be extended to include an executive summary;
- Building Monitors should be reminded of the importance of providing a financial report; and
- the Arts Council should hold a forum for Building Monitors and Arts Council Projects Officers to discuss project monitoring issues.

Appendix 4

Study methodology

The Arts Council's project monitoring arrangements

- We reviewed the Arts Council's arrangements for monitoring the progress of projects, as set out in their Project Monitoring Procedures Manual, and compared these with the 'best practice' guidelines laid down by the Department for Culture, Media and Sport's consultants in September 1996.
- We reviewed the Arts Council's Lottery Advisory Panel and Council papers and minutes relating to project monitoring.
- We examined the arrangements for the Arts Council's appointment of Building Monitors and other specialist monitors and advisers.
- We reviewed the level of financial expertise available within the Arts Council to assist the Lottery Projects Unit in monitoring the financial viability of the grant recipient and the proposals for financing the capital project.

Examination of projects

- The focus of the study is on major capital projects - those awarded a lottery grant of £5 million or more. As at September 1997, there were 24 projects in this category. From these, we selected projects for detailed examination that were sufficiently advanced for the Arts Council to have been actively monitoring their progress, by reference to the extent of work carried out and the proportion of Arts Council grant already paid. The size and value of our sample of projects in relation to the population of projects with grants of £5 million or over is set out in Table 3 below.

Relative size and value of
our sample of projects

Table 3				
	Size		Total grant (£ million)	
Projects awarded a lottery grant of £5 million or more	24		465	
Projects examined	15	63%	317	68%

- For each of the 15 projects, we:
- established the background to the project, including the project aims and objectives, the programme of work, and how the project was being managed and financed (including the sources of partnership funding to supplement the lottery grants);
 - reviewed the Arts Council’s assessment of the application for lottery grant (including any supplementary applications) to identify the risks associated with the project (for example, in raising the required amount of partnership funding) which needed to be monitored;
 - examined the papers submitted to the Lottery Advisory Panel and the Council to assess whether these set out the various options open to the Arts Council and highlighted the risks associated with the project;
 - reviewed the reports submitted by the grant recipient’s project management team and the Arts Council’s Building Monitors and other specialist monitors and advisers;
 - examined the extent to which the Arts Council enforced the special conditions attached to each offer of grant; and
 - examined how the Arts Council responded to the problems identified by their monitoring.

Visits to projects

- We visited each of the 15 projects and conducted interviews with the grant recipient and their project management team. The areas covered in these interviews were:
 - a broad description of the project covering project history, objectives, progress to date and contractual arrangements;
 - project successes and problems, especially relating to design, cost, time, technical/construction and finance (including partnership funding and financial viability);
 - progress towards completion of the project and problems associated with late completion;
 - the arrangements for managing the project; and
 - the recipient's view on the Arts Council's monitoring procedures, including the relationship with the Arts Council's Building Monitor.

Building Monitor focus group









- We conducted a focus group of five of the Arts Council's Building Monitors. Each of the companies represented have considerable experience in acting as Building Monitors for the Arts Council and each was involved on one or more of the 15 projects we examined. The companies represented were:
 - Davis Langdon & Everest;
 - Grant Assessment Monitoring & Evaluation Ltd;
 - Gleeds;
 - Jackson Coles; and
 - Widnell.








The focus group considered and discussed the following aspects of the Arts Council's project monitoring:

- the Arts Council's requirements for monitoring, as understood by Building Monitors;
- the skills required by Monitors to meet these requirements;
- the relationship between Monitors and the projects' sponsors, management and staff;
- reporting to the Arts Council;
- the relationship between Monitors and the Arts Council's Projects Officers; and
- the level and nature of support provided by the Arts Council to their Building Monitors.

Descriptions of the 15 projects examined by the National Audit Office

This pull-out sets out details of the 15 major capital projects we examined, including the cost of the project, the total lottery funding from the Arts Council (some of the 15 projects have received more than one grant) and the project completion date as at 31 October 1998.

	ROYAL OPERA HOUSE, London	ROYAL ALBERT HALL, London	SADLER’S WELLS THEATRE, London	ROYAL NATIONAL THEATRE, London	ROYAL ACADEMY OF DRAMATIC ART, London	ROYAL EXCHANGE THEATRE, Manchester	MILTON KEYNES THEATRE & GALLERY, Milton Keynes	ROYAL COURT THEATRE, London
								
Project description	To redevelop, restore, refurbish and extend the Grade I listed Royal Opera House, thereby preserving it and enabling it to function in the 21st century. It will also provide a home for the Royal Ballet at Covent Garden. Works include improvements to the auditorium; restoration of the Floral Hall and completion of the Covent Garden Piazza; offices, studios, physiotherapy facilities, rest areas and dressing rooms for the Royal Ballet; improvements to stage and technical facilities; and a second auditorium and third performing space.	A 'masterplan' of 30 linked projects to redevelop and transform the Royal Albert Hall into a venue to meet the 21st century demands of audiences and artists and to enhance the environment and ambience of a national monument. Also, by way of increased financial viability, the project aims to enable the grant recipient to invest directly in their cultural programme in order to fulfil their historic remit to 'promote the arts and sciences'.	The redevelopment of Sadler's Wells Theatre to seat 1600, with first class facilities for national and international dance and lyric theatre companies. The refurbished Lilian Baylis studio theatre will seat 200. Both theatres will have greatly improved facilities for audiences, artists and staff. A new lecture theatre, seminar and tutorial rooms will accommodate both expanded community and education facilities and a new arts technology development and training centre for professionals and teachers nationwide. Full disabled access will be provided.	A phased project covering a 'front of house' modernisation scheme, a 'rear of house' scheme and certain minor projects. Plans include enhancing foyers, facilities and the immediate environment; replacement of major items of plant & equipment and renovation of the fabric; investment in Information Technology; refurbishment of the car park; and a capital contribution to the South Bank Employers' Group to improve the local environment.	The Academy's Centenary Project is intended to enable it to achieve financial independence and continue as the foremost centre of excellence of its kind. It includes the purchase of a 99 year lease for premises on Gower and Malet Street and redevelopment and refurbishment of those premises; redevelopment and refurbishment of premises in Chenies Street; relocation expenses while work is carried out; repayment of the Academy's operating deficit; and the creation of a trust fund to underwrite any future shortfall in annual income. The combined cost of the last two elements (£6 million) is being counted as partnership funding.	The refurbishment and alteration of the existing Royal Exchange Theatre to provide new facilities, including a studio theatre, and to upgrade the original auditorium. Project costs include the purchase of a 25 year lease on the existing building and the cost of purchasing and modifying another building as an outside workshop and storage unit. Although the original aims of the project remained largely unchanged, the scope and value of the project was significantly increased in the aftermath of the Manchester bomb explosion in June 1996. This occurred just as the original application was about to be considered by the Arts Council.	The design, building and equipping of a new arts complex comprising a 1,330 seat theatre and a mixed media gallery.	Restoration of the 395 seat Royal Court Theatre (a Grade II listed building) and 60 seat Theatre Upstairs and upgrading of facilities. In addition to the rear wing being rebuilt and enlarged, a new basement bar and restaurant is planned to extend underneath the road into Sloane Square. Disabled access for audience and staff will be significantly improved. Modern and more cost effective equipment will be installed. The project also includes a closure plan to enable the main Theatre and the Theatre Upstairs to operate during rebuilding. The project originally included the development of a second studio for the Young People's Theatre but this element was removed in October 1996.
Grant Recipient	Royal Opera House, Covent Garden Limited	Corporation of the Hall of Arts and Sciences	New Sadler's Wells Ltd	Royal National Theatre Board	Royal Academy of Dramatic Art	Royal Exchange Theatre Company Ltd	Milton Keynes Borough Council	English Stage Company Ltd
Project cost	£214,000,000	£66,317,000	£52,518,000	£42,820,000	£32,428,000	£31,999,000	£30,954,000	£25,832,000
Arts Council lottery grant	£78,500,000 (37%)	£20,200,000 (30%) (The Heritage Lottery Fund has also made a grant of £20,180,000 to this project)	£36,000,000 (69%)	£31,590,000 (74%)	£23,746,841 (73%)	£23,057,250 (72%)	£20,171,485 (65%)	£18,825,850 (73%)
Completion date	December 1999	December 2003	October 1998 (main theatre) September 2001 (all phases)	'Front of house' scheme completed December 1997. Other elements programmed for completion between 1998 and March 2000.	April 2000 (Gower St/Malet St); September 2001 (Chenies St)	November 1998	June 1999	June 1999

	VICTORIA HALL & REGENT THEATRE, Stoke-on-Trent	SHAKESPEARE GLOBE THEATRE, London	NATIONAL CENTRE FOR POPULAR MUSIC, Sheffield	CAMBRIDGE ARTS THEATRE, Cambridge	NATIONAL GLASS CENTRE, Sunderland	DOVECOT ARTS CENTRE, Stockton-on-Tees	MALVERN FESTIVAL THEATRE, Malvern
							
Project description	The creation of two flagship venues within the new Hanley Cultural Quarter. The existing Victoria Concert Hall will be upgraded to modern standards with new front of house, improved disabled access, and improvements to auditorium, technical and backstage facilities. The disused Regent Theatre (a Grade II* listed Art Deco cinema-theatre) will be transformed into a touring venue for ballet, opera, drama and musicals following restoration and major refurbishment providing disabled access and improved public, technical and backstage facilities to modern standards.	The authentic reconstruction of the Elizabethan Globe Theatre of 1599 and a Jacobean indoor theatre designed by Inigo Jones in about 1617. The theatres are supported by facilities for audiences and performers. These theatres form part of the Shakespeare Globe Centre, which includes exhibition, teaching and academic facilities. Design work was complete and construction underway (with £6.9 million of work already undertaken) before the Trust applied for lottery funding.	A new technology-based visitor attraction celebrating the success and diversity of popular music from around the world. Both educational and entertaining, it will provide a mix of changing exhibits and diverse facilities including interactive displays, soundscapes, a large area dedicated to educational activities, an outdoor public performance space, children's area, café and bar. Occupying a 0.5 acre site in the cultural quarter of Sheffield, it hopes to attract about 400,000 visitors each year.	Refurbishment of the Cambridge Arts Theatre; renovation and repairs to the Festival Theatre; and a feasibility study of the creation of a three screen Cinematheque on the site of the existing Arts Cinema.	The construction, fitting-out and operation of a new-build complex, incorporating temporary and permanent galleries housing major glass exhibitions; a visitor attraction telling the Story of Glass, for which Sunderland is historically renowned; and space to let for glass manufacturing businesses and associated retail and support facilities. The building was the subject of an architectural competition, making a major and innovative use of glass, and promises to be an attraction in itself.	Creation of a new cultural building within Stockton-on-Tees regeneration area to include a 300-600 seat performance space, a 250 seat theatre, a 120 seat cinema, several participation spaces and full trading facilities. The new Centre will enable the continued provision of a wide range of high quality participatory arts activities and the presentation of a wide programme of drama, music, dance, comedy, cabaret, and media arts.	To upgrade the facilities at Malvern's Festival Theatre to transform it into a more unified centre for theatre and the arts. The complex comprises three auditoria: the 880 seat Festival Theatre, the 950 seat Elgar Hall and the 450 seat Shaw Cinema, each of which has a separate entrance and identity. The project will not only provide those who attend and work in the complex with greatly improved facilities, but will allow for an extension of the range of work presented so as to develop the tastes of the existing audience and attract new ones.
Grant Recipient	Stoke-on-Trent City Council	The Shakespeare Globe Trust/International Shakespeare Globe Centre Ltd.	Music Heritage Ltd	Cambridge Arts Theatre Trust	Tyne and Wear Development Corporation	Dovecot Arts Trust Limited	Malvern Festival Theatre Trust
Project cost	£24,587,000	£16,826,000 (three theatre elements)	£14,977,000	£12,674,000	£12,562,000	£9,108,000	£6,880,000
Arts Council lottery grant	£16,135,000 (66%)	£12,400,000 (74%)	£11,085,000 (74%)	£7,390,000 (58%)	£6,901,000 (55%)	£6,631,750 (73%)	£5,087,640 (74%)
Completion date	October 1998 (Victoria Hall) May 1999 (Regent Theatre)	June 1997 (The Globe Theatre) October 2000 (basement exhibition and Inigo Jones Theatre)	March 1999	December 1996	June 1998	December 1998	March 1998